Under Minor Construction

THE ADVISOR'S GUIDE TO CHARITABLE GIVING, ORGANIZATIONS, AND CREATIVE STRUCTURING

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Charity is equal in importance to all other commandments combined.

—Talmud Bavli Massekhet Baba Bathra 9a

We make a living by what we get; we make a life by what we give.

—Winston Churchill

What makes a lawyer stand out in a crowded field of experienced, technically proficient transactional attorneys?

Do you think your clients know whether your documents reflect current statutory guidelines and binding case laws, or incorporate the appropriate legal terms and provisions necessary to accomplish their estate plans?

Will clients know when you dotted every “i” and crossed every “t”?

In my years as a CPA, Series 65 investment advisor, holistic wealth manager, business owner, and fiduciary to my clients, I discovered that it’s the soft touch factors that speak to a client’s heart and elicit referrals without the need for advertising.

Clients may not remember the technical issues you discussed with them, but they will remember how you made them feel when you thoughtfully listened, delineated their goals, and collaborated with them to put together a plan that actualizes their philanthropic vision.

What’s even more dazzling is when you proactively reach out with ideas that clients could not have independently considered.

This Advisor’s Guide to Charitable Giving may hone your legal expertise and stir ideas for introducing ways to dovetail charitable giving in your clients’ plans. Assisting clients design and realize their legacies yields a win-win-win for advisors, clients, and charities.

Be your clients’ sherpa! Embrace your formidable role. Use this Guide as your map.

— P. Jill Ashley

CPA, Independent Investment Advisor, Wealth Manager
2L law student, Stetson College of Law
Part-time Law Clerk – Gassman, Crotty & Denicolo, P.A.

Plans fail for lack of counsel, but with many advisers they succeed. – Proverbs 15:22

EZ LEARNING CHARTS FOR CHARITABLE TAX LAW

The following charts provide an overview of the charitable entities that we discuss throughout this book. The charts explain how the entities interact with various planning strategies, limitations, and rules. We have chosen to include them at the beginning of the book, although they will likely be much more useful while reading the relevant chapter. For this reason, we recommend returning to these charts as you read this book.

Chart A: Deduction for Donation
This chart summarizes the charitable deduction rules for the major types of charitable entities that are discussed in this book. Further discussion of the charitable deduction is available in Chapter 1.

Charts B, C, and D: Ownership of Partnership Interests, C Corporation Stock, and S Corporation Stock
This chart summarizes the rules related to the ownership of these interests by the major charitable entities discussed in this book. Further discussion of ownership of these entities by charitable entities is available in Chapters 2 and 3.

Chart E: Unrelated Business Taxable Income
This chart summarizes how the rules related to unrelated business taxable income (UBTI) apply to the major types of charitable entities that are discussed in this book. Further discussion of UBTI is provided in Chapters 1 and 4.

Chart F: Self-Dealing and Excess Business Holding Rules
The self-dealing and excess business holding rules are perilous traps for the unwary. This chart compares the applicability of these rules to the major types of charitable entities that are discussed in this book. Chapter 4 provides extensive explanation of these rules.

Chart G: Summary of Restrictions Applicable to Various Types of Charitable Entities
This table summarizes much of the material from the book, providing an overview of which of the rules and restrictions apply to each charitable entity. Further discussion of these rules is provided in Chapter 4, but the material in Chart G is relevant to nearly any discussion of charitable gift planning.

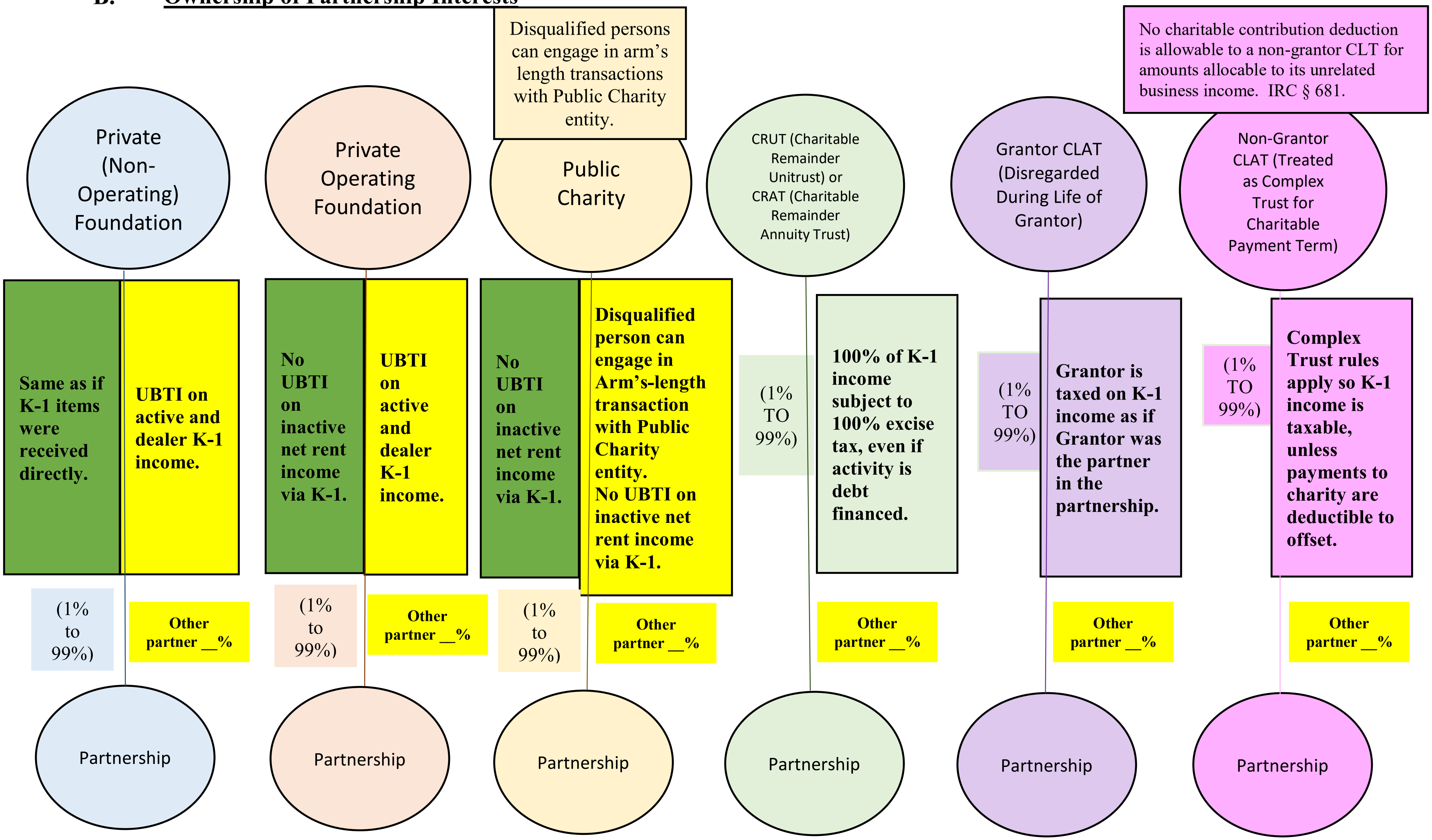
Chart H: Comparison of a Charitable Remainder Trust, Charitable Gift Annuity, and a Pooled Income Fund
Charitable Remainder Trusts, Charitable Gift Annuities, and Pooled Income Funds are important tools for charitable gift planning. This table compares their similarities and differences and will be helpful to reference any time these charitable arrangements are discussed throughout the book. Further discussion of Charitable Remainder Trusts, Charitable Gift Annuities, and Pooled Income Funds can be found in Chapter 2.

A. Deduction for Donation

Private (Non-Operating) Foundation	Private Operating Foundation	Public Charity	CRUT (Charitable Remainder Unitrust) or CRAT (Charitable Remainder Annuity Trust)	Grantor CLAT (Disregarded During Life of Grantor)	Non-Grantor CLAT (Treated as Complex Trust for Charitable Payment Term)
Can be funded or controlled by one person or family. Charitable deduction limited to lower of basis or FMV of donated assets other than publicly traded securities. Donor can deduct only up to 20% of AGI for contributions of securities—and carry forward any excess for 5 years. Subject to 1.39% annual excise tax on net income. Must generally distribute/spend 5% of net market value annually.	**Same as Private Non-Operating Foundation**, but must "operate" a charitable activity or venture. Charitable deduction rules are the same as Public Charity—Up to 30% AGI for FMV of appreciated capital gain assets (not accelerated depreciation or dealer property gain); Up to 20% AGI for non-appreciated assets; and up to 60% for cash. Must generally spend or distribute 4.25% of the trust's net market value each 3 of 4 years.	May qualify by being a physical school, medical facility ("hospital"), medical research organization, house of worship, or satisfying "Over-33% Test" or "Over-66% Test." No minimum distribution requirements. No self-dealing prohibitions. Same donation deductibility rights as Private Operating Foundation contributors.	A simple CRUT or CRAT makes annual payments to one or more individuals, with remainder to charity. Charity's remainder interest must be worth at least 10%, and normally the contributor will receive a tax deduction based thereon. Can contribute appreciated assets and defer income tax on sale by CRT and income thereon until payments are received. Charitable deduction for value of charitable remainder interest.	Considered as owned by Grantor for income tax purposes. Therefore, not subject to self-dealing and other rules. Grantor gets income tax deduction for contribution and pays income tax on net income during charitable term. Remainder passes estate and gift tax-free to family members or comes back to the Grantor.	Taxed as an irrevocable "complex" trust. No income tax deduction for contribution. Grantor not taxable on income.

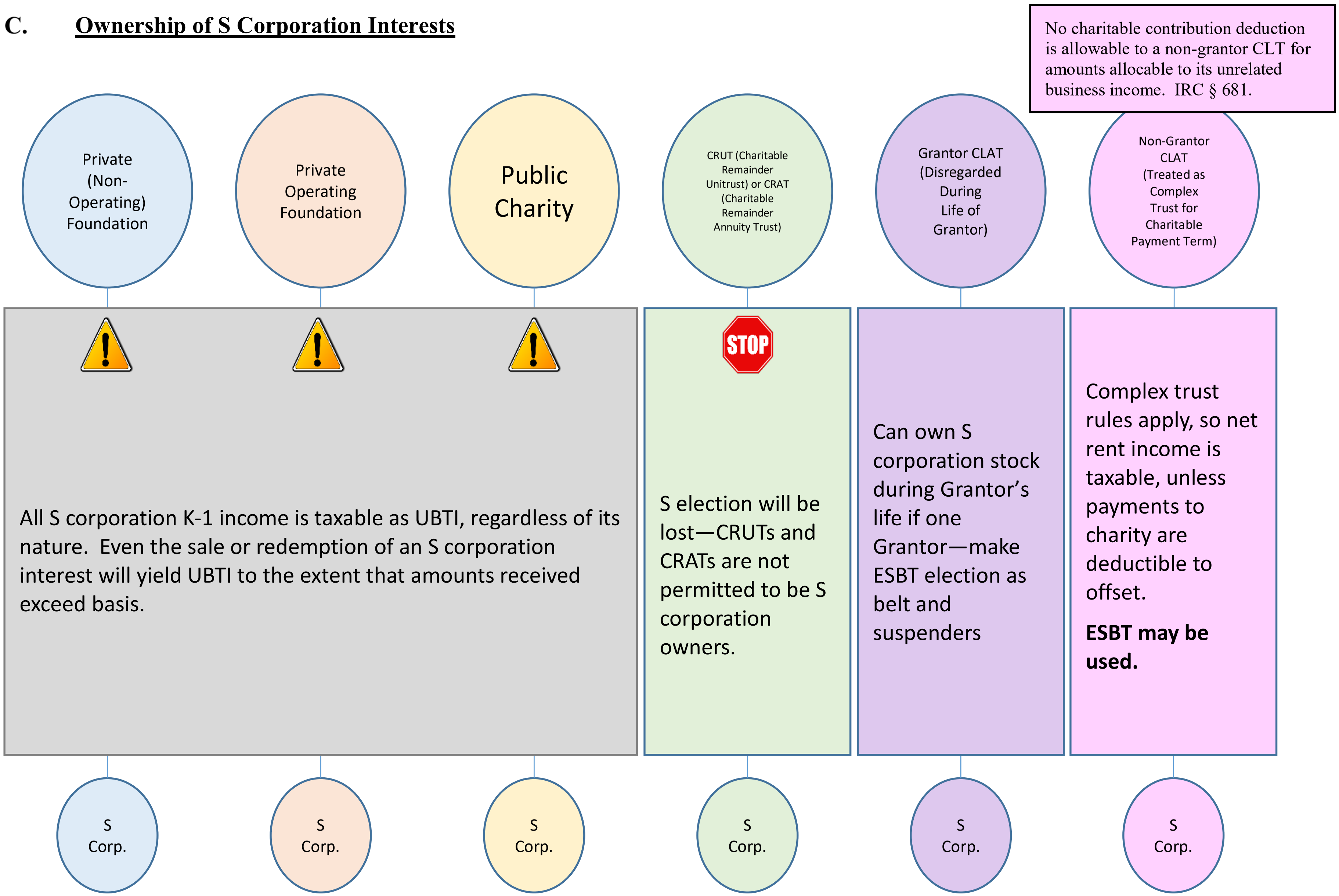
UBTI Tax is based on K-1 reporting (not cash received).
Charitable activities with the charity owning the partnership interest may be exempt.

B. Ownership of Partnership Interests

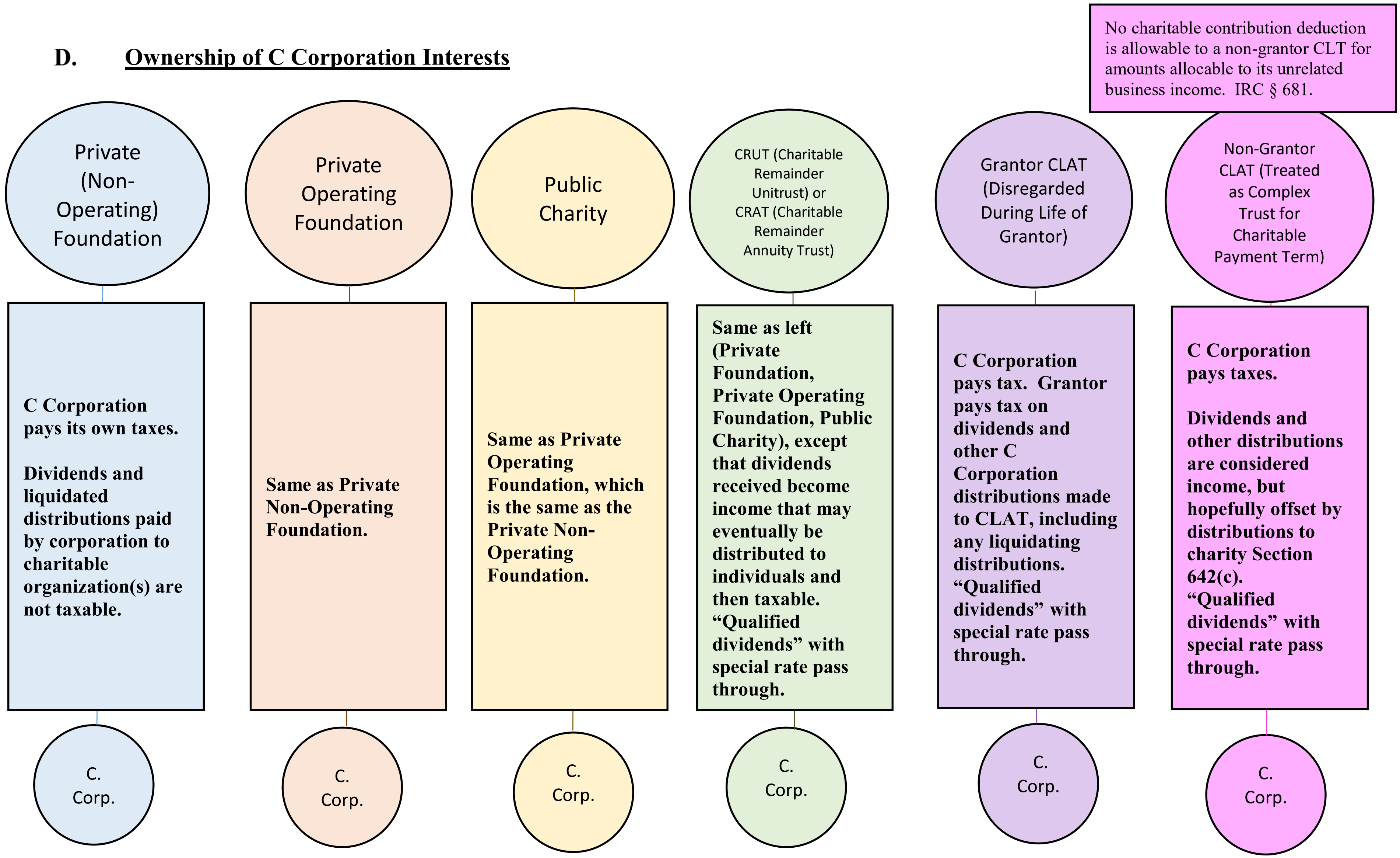


Consider transferring partnership interest into C Corporation owned by charity – This may trigger income tax if debt of partnership exceeds basis of partnership assets.

C. Ownership of S Corporation Interests



D. Ownership of C Corporation Interests



E. Unrelated Business Taxable Income

Unrelated Business Taxable Income (UBIT) from Rent Based Upon Percentage of Profit or Dealer Sale Income Treatment and More than Incidental Leasing of Personal—Non-Real Estate—Assets and Income from Businesses Not Related to the Charitable Purpose of the Organization
(Assume there is no debt on property, or that debt qualifies under 10 year exception.)
Taxation of Ownership of Real Estate – 100% Ownership or Ownership as Tenants-In-Common ("TIC") Not Taxed as Partnership
No tax on receipt of dividends or other distributions from C Corporation.

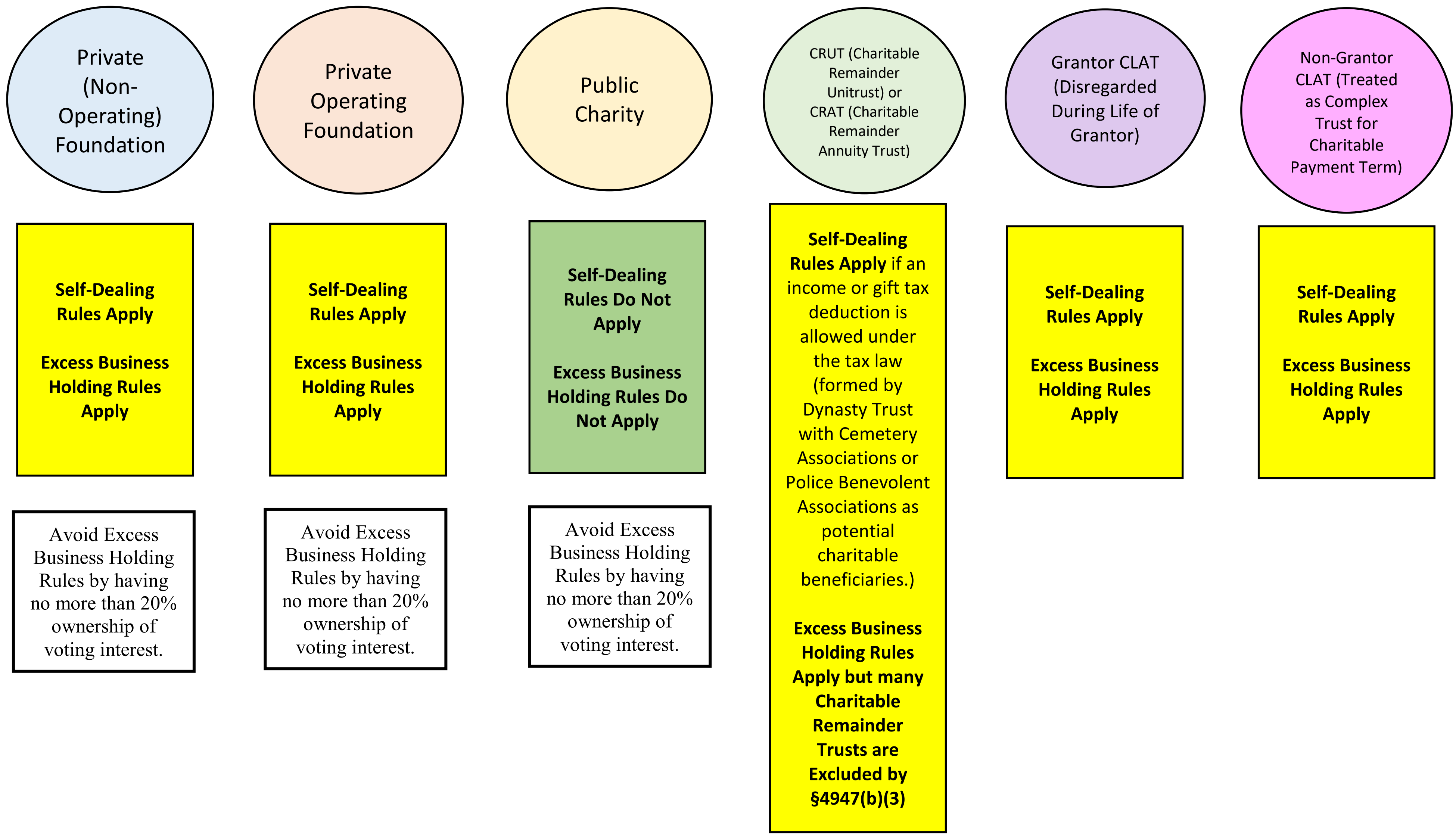
Private (Non-Operating) Foundation	**No tax or UBTI on passive net rent income or non-dealer CAP gains. Debt on property can cause rent or cap gains to be taxable.**
	Active business income, sale of property as dealer, or income on property subject to certain debt results in UBTI.
Private Operating Foundation	**Same as Private Non-Operating Foundation.**
Public Charity	**Same as Private Non-Operating Foundation.**
CRUT (Charitable Remainder Unitrust) or CRAT (Charitable Remainder Annuity Trust)	**Inactive: Net rent not taxable. Debt on property can cause rent to be taxable.**
	Active Rent or Dealer Income: 100% Excise tax.
Grantor CLAT (Disregarded During Life of Grantor)	**Grantor pays tax on rent income minus depreciation deduction.**
	Grantor pays tax as if Grantor was the dealer or active landlord.
Non-Grantor CLAT (Treated as Complex Trust for Charitable Payment Term)	**Taxes as in irrevocable trust – can probably deduct annual payments to charity under Section 642(c).**

No charitable contribution deduction is allowable to a non-grantor CLT for amounts allocable to its unrelated business income. IRC § 681.

**** Note: UBTI is taxed at corporate or trust rate, depending upon whether Foundation is a corporation or a Trust.**

- **Too much UBTI can trigger loss of 501(c)(3) status.**
- **Entity may make distributions to other charities and receive deduction against UBTI subject to 10% limitation for charitable and more complicated higher limitation for charitable trusts.**
- **Place taxable activity under C Corporation to avoid UBTI—will be taxed at C Corporation level—depending on the type of income received (i.e. LTCG/QD income taxed at 20% w/50% offset v. 21% w/10% offset).**
- **The charity (corporation) rate for UBTI is less (21%), but the offset may be less (10%). Whereas a charity (operating as trust) rate is up to 37% top rate for trusts, but with a higher potential offset if the organization in turn makes distributions to charity.**
- **A charity can establish a related sister organization in different form as trust or corporation to receive UBTI if advantageous.**
- **No tax on receipt of dividends or other distributions from C Corporation.**

F. Self-Dealing and Excess Business Holding Rules



G. Summary of Restrictions Applicable to Various Types of Charitable Entities

Summary of Restrictions Applicable to Different Types of Charitable Entities										
Entity	**Possible Cost**	**Full Tax Deduction**	**Private Inurement**	**Self-Dealing**	**Excess Business Holdings**	**Unrelated Business Taxable Income**	**Can Own S Corp Stock**	**Can Own Donor Controlled C Corp Stock**	**Can Receive IRA Qualified Charitable Distributions**	**Can Directly Benefit a Foreign Charity**
Charitable Remainder Trust	Legal fees to create and administer trust	Based on present value of interest going to charity	Prohibited, but some exceptions apply	Prohibited, but some exceptions apply	Not prohibited	Yes. Taxed at 100% bracket	No	Yes	Taxpayers are permitted a one-time $50,000 distribution	No
Private Foundation	Legal & application fees; May need to hire employees	Yes, but sometimes limited to basis for certain gifts of appreciated non-publicly traded securities	Prohibited	Prohibited	Prohibited	Yes	Yes, but will generate UBIT	Yes	No	No
Private Operating Foundation	Legal & application fees; May need to hire employees	Yes	Prohibited	Prohibited	Prohibited	Yes	Yes, but will generate UBIT	Yes	Yes	No
Donor Advised Fund	Little to no cost	Yes	Prohibited	Prohibited	Prohibited	Yes	Yes, but will generate UBIT	Yes	No	No

Summary of Restrictions Applicable to Different Types of Charitable Entities										
Entity	**Possible Cost**	**Full Tax Deduction**	**Private Inurement**	**Self-Dealing**	**Excess Business Holdings**	**Unrelated Business Taxable Income**	**Can Own S Corp Stock**	**Can Own Donor Controlled C Corp Stock**	**Can Receive IRA Qualified Charitable Distributions**	**Can Directly Benefit a Foreign Charity**
Community Foundation	Little to no cost	Yes	Prohibited	Not Prohibited, but Private Benefit Doctrine applies	Prohibited	Yes	Yes, but will generate UBIT	Yes	Yes	No
Public Charity	Legal & application fees; May need to hire employees	Yes	Prohibited, Private Benefit Doctrine	Not Prohibited, but Private Benefit Doctrine applies	Not prohibited, but Commensurate in Scope Doctrine applies	Yes	Yes, but will generate UBIT	Yes	Yes	No
Charitable Lead Annuity Trust	Legal & application fees; May need to hire employees; plus possible income taxes	Only for a Grantor CLAT	Prohibited	Prohibited	Prohibited, if the deduction for the income interest is over 60%	Yes	Unclear and may generate UBIT; Grantor CLAT can own S Corp. stock; A non-grantor CLAT may make an ESBT election to own S Corp. stock	Yes	No	Yes if a non-grantor CLT and not an ESBT; Eligible for § 642(c) deduction

Summary of Restrictions Applicable to Different Types of Charitable Entities

Entity	Possible Cost	Full Tax Deduction	Private Inurement	Self-Dealing	Excess Business Holdings	Unrelated Business Taxable Income	Can Own S Corp Stock	Can Own Donor Controlled C Corp Stock	Can Receive IRA Qualified Charitable Distributions	Can Directly Benefit a Foreign Charity
Incomplete Charitable Trust	Legal fees to create and administer-income taxes	Only receive a deduction when money is transferred to charity	Not Prohibited	Not Prohibited	Not Prohibited	No	Yes, if Grantor Trust or ESBT	Yes	No	Yes
501(c)(4)	Legal fees and application fees	Only a gift and estate tax deduction	Prohibited	Do Not Apply	Do Not Apply	Yes	Do Not Apply	Yes	No	No

H. Comparison of a Charitable Remainder Trust, Charitable Gift Annuity, and a Pooled Income Fund

Comparison of a Charitable Remainder Trust, Charitable Gift Annuity, and a Pooled Income Fund						
Entity	**Donor Can Donate Appreciated Assets and Get a Tax Deduction Against Ordinary Income**	**Control/Payments**	**Calculation of Payments**	**Notable Characteristics of Payments**	**Income Taxation of Payments Received**	**Death of Donor**
Charitable Remainder Trust	Yes. Funding a CRT with appreciated property will not result in a capital gain to the donor unless either the donor receives property in exchange (other than retention of an annuity or unitrust amount) or the property transferred to the trust has indebtedness in excess of its basis.	Donor Controlled – Pays stream of payments; Remainder to charity Term can be for up to 20 years and/or life.	Will vary depending upon design of Trust	See Chapter 2.	Income comes out "worse first" using tier system. After all taxable income is paid, tax-free income and principal come out income tax-free.	May end or continue depending upon terms.

Comparison of a Charitable Remainder Trust, Charitable Gift Annuity, and a Pooled Income Fund

Entity	Donor Can Donate Appreciated Assets and Get a Tax Deduction Against Ordinary Income	Control/Payments	Calculation of Payments	Notable Characteristics of Payments	Income Taxation of Payments Received	Death of Donor
Charitable Gift Annuity	Yes. If the annuity is purchased with appreciated property, the donor's basis must be allocated between the gift portion and the bargain sale portion.	Controlled by Charity – Annuitant(s) will receive a stream of payments based upon the type/version of the agreement. Charitable gift annuities are not issued for a fixed term of years, but it is possible to terminate the annuity payments in advance of the life measuring term.	<u>Three Types of Agreements:</u> Can be immediate, deferred, or flexible annuity <u>Three "Versions" of Each Type of Agreement:</u> #1: A "single life" agreement (the annuity is paid to only one person for his/her lifetime); #2: A "two lives in succession" agreement (the annuity is paid to "A" and then if "B" survives "A", the annuity is paid to person "B"); #3: A "joint and survivor" agreement (the annuity is paid to two persons simultaneously; At the death of the first annuitant, the survivor is paid the full annuity amount).	Dependent upon the charity not going bankrupt—In bankruptcy, the holder of a charitable gift annuity is an unsecured creditor. Charitable gift annuities are backed by the assets of the charity. Thus, payments are dependent upon the issuing charity being solvent and able to make the annuity payments.	Payments through life expectancy taxed as ordinary income and return of capital in uniform proportion. The non-deductible portion of the annuity is returned to the annuitant over his or her life expectancy. Once the non-deductible portion of the annuity is paid to the annuitant, the payments are then taxed as ordinary income.	Payments end after the death of the donor, or after the death of the donor and another person.

Comparison of a Charitable Remainder Trust, Charitable Gift Annuity, and a Pooled Income Fund

Entity	Donor Can Donate Appreciated Assets and Get a Tax Deduction Against Ordinary Income	Control/Payments	Calculation of Payments	Notable Characteristics of Payments	Income Taxation of Payments Received	Death of Donor
Pooled Income Fund	Yes. The donor realizes no taxable gain (or loss) as a result of making a gift to a pooled income fund if the transferred property is not encumbered by debt.	Controlled by Charity – Donor receives a stream of payments. A pooled income fund may not have an income interest measured by a term of years. The term of the income interest must be measured by the life of each individual beneficiary.	Payments vary in amount based on the performance of the fund for such taxable year. The amount received by the donor or other income beneficiary is proportional to the donor's share of the fund. The donor must retain an income interest for his or her life or create a life income interest in one or more beneficiaries living at the date of the transfer.	Insulated from the debts of the charity	Payments taxed as ordinary income.	Remaining funds go to charity upon the death of the last income beneficiary. Donor may reserve the testamentary right to terminate or revoke the income interest of any designated beneficiary other than that of the charitable remainder beneficiary.

FORWARD

This book is the result of five years of research, writing, and hair pulling. We have worked hard to boil down these concepts, researching and struggling to try to bring them to the level where a practitioner can easily understand and use these laws for the benefit of charities and donors.

A basic premise of this book is that tax, financial, and wealth advisors do not have sufficient knowledge to understand the paths to getting a tax deduction in many circumstances. Too many taxpayers cannot find literature and also cannot find an advisor to help them… because too many advisors do not know the answer… because the vast majority of the literature has not been user friendly. Our hope is to help end that vicious cycle.

We thank Jerry Hesch, Karl Mill, Erik Dryburgh, Turney Berry, Conrad Teitell, Bruce Hopkins, Richard Fox, and many others who have published articles on these topics in recent years. We are hoping that this book is the next step forward in getting a firm grasp of charitable giving opportunities for many readers.

We have donated this book to the National Institute for Charitable Education (what a NICE name!), a 501(c)(3) corporation, in large part to enable law students to satisfy their pro bono hours while getting writing experience. All proceeds from the sale of this book are going to NICE to help defray the expenses that law students have when they do pro bono work. Please send me an email if you know any law students who are interested.

Through NICE, we intend to continuously update and improve this book. We welcome reader feedback and look forward to hearing how this book has helped readers, donors, and charities, and their suggestions for how it can be improved to better assist future readers.

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SELECTED DEFINITIONS

The following definitions are from the extensive glossary found at the end of this Book. Many of these terms have been derived from IRS literature.

Term	Definition
501(c)(3) Charitable Organization	"To be tax-exempt under section 501(c)(3) of the Internal Revenue Code, an organization must be organized and operated exclusively for exempt purposes set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual. In addition, it may not be an action organization, i.e., it may not attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates. Organizations described in section 501(c)(3) are commonly referred to as charitable organizations. Organizations described in section 501(c)(3), other than testing for public safety organizations, are eligible to receive tax-deductible contributions in accordance with Code section 170. The organization must not be organized or operated for the benefit of private interests, and no part of a section 501(c)(3) organization's net earnings may inure to the benefit of any private shareholder or individual. If the organization engages in an excess benefit transaction with a person having substantial influence over the organization, an excise tax may be imposed on the person and any organization managers agreeing to the transaction. Section 501(c)(3) organizations are restricted in how much political and legislative (lobbying) activities they may conduct."[1]
501(c)(4) Organizations	"Internal Revenue Code section 501(c)(4) provides for the exemption of two very different types of organizations with their own distinct qualification requirements. They are: • Social welfare organizations: Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, and • Local associations of employees, the membership of which is limited to the employees of a designated person(s) in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational or recreational purposes. Homeowners associations and volunteer fire companies may be recognized as exempt as social welfare organizations if they meet the requirements for exemption. Organizations that engage in substantial lobbying activities sometimes also are classified as social welfare organizations."[2]

[1] *Exemption Requirements - 501(c)(3) Organizations*, I.R.S. (Feb. 17, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/exemption-requirements-501c3-organizations.
[2] *Types of Organizations Exempt under Section 501(c)(4)*, I.R.S. (Aug. 2, 2022), https://www.irs.gov/charities-non-profits/other-non-profits/types-of-organizations-exempt-under-section-501c4.

Term	Definition
Charitable Gift Annuity	"[T]he term 'charitable gift annuity' means an annuity if— (A) a portion of the amount paid in connection with the issuance of the annuity is allowable as a deduction under section 170 or 2055, and (B) the annuity is described in section 514(c)(5) (determined as if any amount paid in cash in connection with such issuance were property)."[3]
Charitable income tax deduction	"Contributions must actually be paid in cash or other property before the close of your tax year to be deductible, whether you use the cash or accrual method. . . . If you donate property other than cash to a qualified organization, you may generally deduct the fair market value of the property. If the property has appreciated in value, however, some adjustments may have to be made. . . . In general, contributions to charitable organizations may be deducted up to 50 percent of adjusted gross income computed without regard to net operating loss carrybacks. Contributions to certain private foundations, veterans organizations, fraternal societies, and cemetery organizations are limited to 30 percent adjusted gross income (computed without regard to net operating loss carrybacks), however. . . . The 50 percent limitation applies to (1) all public charities (code PC), (2) all private operating foundations (code POF), (3) certain private foundations that distribute the contributions they receive to public charities and private operating foundations within 2-1/2 months following the year of receipt, and (4) certain private foundations the contributions to which are pooled in a common fund and the income and corpus of which are paid to public charities. The 30 percent limitation applies to private foundations (code PF), other than those previously mentioned that qualify for a 50 percent limitation, and to other organizations described in section 170(c) that do not qualify for the 50 percent limitation, such as domestic fraternal societies (code LODGE)."[4]
Charitable Lead Annuity Trust (CLAT)	"In a CLAT, the trust pays a uniform payment to the charity. A grantor establishes the trust to benefit the remainder beneficiary, as it is usually the grantor or the grantor's designee. Any property appreciation remains in the trust to benefit the remainder beneficiary."[5]
Charitable Lead Trust (CLT)	"This is a split-interest trust that annually pays a fixed annuity or unitrust amount to a charitable organization for the lead period specified in the trust instrument. The lead period may be a term of years or it may be a period determined by the lifetime of one or more individuals . . . . The donor to the trust will have been allowed a deduction under one of the sections listed in section 4947(a)(2). At the end of the lead period, annual payments to the charitable organization cease, and the remaining corpus becomes payable, outright or in trust, to a noncharitable (private) beneficiary."[6]

[3] I.R.C. § 501(m)(5).
[4] *Charitable Contribution Deductions*, I.R.S. (Aug. 25, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contribution-deductions.
[5] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 1, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[6] *Instructions for Form 5227 (2021)*, I.R.S. (Dec. 22, 2021), https://www.irs.gov/instructions/i5227.

Term	Definition
Charitable Limited Liability Company	"If the sole owner of a disregarded limited liability company is a tax-exempt organization described in section 501(a) of the Code, then the limited liability company is treated as a component part of the exempt organization. In such a situation, the exempt owner of the disregarded limited liability company generally must treat the operations of the limited liability company as a branch or division of the owner and include, as the owner's own, information pertaining to the finances and operations of the limited liability company in filing an annual information return as required under section 6033 of the Code. As a general rule, a disregarded limited liability company whose sole owner is exempt from federal income tax under section 501(a) of the Code is not required to pay federal taxes or file a federal tax or information return; that is the responsibility of its sole owner. The disregarded entity generally receives the benefit of its owner's tax-exempt status, including exemption from federal income tax, federal unemployment tax, and other federal taxes where applicable."[7]
Charitable Remainder Annuity Trusts (CRAT)	"A charitable remainder annuity trust (CRAT) is a charitable remainder trust in which the income payments to the non-charitable beneficiary are fixed throughout the life of the trust. The trustee(s) calculate the payment amount by multiplying the designated percentage by the fair market value of the assets initially placed in the trust."[8] "The amount is at least 5% and no more than 50% of the value of the corpus (property in the trust) when the trust is established."[9]

[7] I.R.S. Information Letter 2010-0052 (Mar. 15, 2010)
[8] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 1, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[9] *Charitable Remainder Trusts*, I.R.S. (Aug. 22, 2022), https://www.irs.gov/charities-non-profits/charitable-remainder-trusts.

Term	Definition
Charitable Remainder Trust	“Charitable remainder trusts (CRT) are split-interest trusts in which a noncharitable beneficiary receives a stream of income for the duration of the trust, and a designated charity receives the remaining trust assets upon termination. Charitable remainder trusts can be either annuity trusts or unitrusts, depending on the method used to calculate the payment amounts. Further, unitrusts can be of the net income or net income with makeup variety.”[10] “In a charitable remainder trust: • A donor transfers property, cash or other assets into an irrevocable trust • The trust's basis in the transferred assets is carryover basis, which is the same basis that it would be in the hands of the donor, for assets transferred to the trust during the lifetime of the donor • The trust pays income to at least 1 living beneficiary • The payments continue for a specific term of up to 20 years or the life of 1 or more beneficiaries • At the end of the payment term, the remainder of the trust passes to 1 or more qualified U.S. charitable organizations • The remainder donated to charity must be at least 10% of the initial net fair market value of all property placed in the trust Charitable remainder trusts are irrevocable. Assets that go in can't be taken back. There are 2 types of charitable remainder trusts based on how they pay beneficiaries [Charitable Remainder Annuity Trusts and Charitable Remainder Unitrusts]. Both types of trusts can be made while the donor is alive (inter vivos) or upon death (testamentary).”[11]
Charitable Remainder Unitrust (CRUT)	“A charitable remainder unitrust (CRUT), also called a unitrust, is a charitable remainder trust in which the income payments to the non-charitable beneficiary fluctuate with the fair market value of the assets in the trust. The trustee(s) calculate the payment amount by multiplying the designated percentage (called the unitrust percentage) by the fair market value of the assets, as they are valued each year. Unitrusts can have net income or net income with makeup provisions.”[12] “A charitable remainder unitrust (CRUT) pays a percentage of the value of the trust each year to noncharitable beneficiaries. The payments generally must equal at least 5% and no more than 50% of the fair market value of the assets, valued annually.”[13]

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[10] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[11] *Charitable Remainder Trusts*, I.R.S. (Aug. 22, 2022), https://www.irs.gov/charities-non-profits/charitable-remainder-trusts.
[12] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[13] *Charitable Remainder Trusts*, I.R.S. (Aug. 22, 2022), https://www.irs.gov/charities-non-profits/charitable-remainder-trusts.

Term	Definition
Disqualified Person	"A disqualified person is any person who was in a position to exercise substantial influence over the affairs of the applicable tax-exempt organization at any time during the lookback period. It is not necessary that the person actually exercise substantial influence, only that the person be in a position to do so. . . . Family members of the disqualified person and entities controlled by the disqualified person are also disqualified persons. For this purpose, the term control is defined as owning more than 35 percent of the voting power of a corporation, more than 35 percent of the profits interest in a partnership, or more than 35 percent of the beneficial interest in a trust."[14] "A disqualified person is any of the following. 1. A substantial contributor. 2. A foundation manager. 3. A person who owns more than 20% of a corporation, partnership, trust, or unincorporated enterprise, which is itself a substantial contributor. 4. A member of the family of an individual in the first three categories. 5. A corporation, partnership, trust, or estate in which persons described in (1), (2), (3), or (4) above own a total beneficial interest of more than 35%. 6. For purposes of section 4943 (excess business holdings), a disqualified person also includes: a. A private foundation which is effectively controlled (directly or indirectly) by the same persons who control the trust in question, or b. A private foundation substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in (1), (2), or (3) above, or members of their families, within the meaning of section 4946(d), who made (directly or indirectly) substantially all of the contributions to the trust in question. 7. For purposes of section 4941 (self-dealing), a disqualified person also includes certain government officials."[15]
Donor Advised Fund	"Generally, a donor advised fund is a separately identified fund or account that is maintained and operated by a section 501(c)(3) organization, which is called a sponsoring organization. Each account is composed of contributions made by individual donors. Once the donor makes the contribution, the organization has legal control over it. However, the donor, or the donor's representative, retains advisory privileges with respect to the distribution of funds and the investment of assets in the account."[16]

[14] *Disqualified Person - Intermediate Sanctions*, I.R.S. (Aug. 1, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/disqualified-person-intermediate-sanctions.
[15] *Instructions for Form 5227 (2021)*, I.R.S. (Dec. 22, 2021), https://www.irs.gov/instructions/i5227.
[16] *Donor-advised Funds*, I.R.S. (Aug. 1, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/donor-advised-funds.

Term	Definition
Private Foundation	One of two classes of 501(c)(3) organizations, along with Public Charities. "In general, a private foundation is any section 501(c)(3) organization that does not fall into one of the categories specifically excluded from the definition of that term ['public charities']. Some tax law provisions apply to all private foundations. Others, however, are more narrowly focused on particular types of private foundations. Moreover, special rules apply to certain private foundations, and to organizations that are not private foundations and certain non-exempt entities. For tax purposes, it may be necessary to distinguish between the following types of foundations: 1. Private operating foundations 2. Exempt operating foundations 3. Grant-making (private nonoperating) foundations"[17] "Private foundations . . . typically have a single major source of funding (usually gifts from one family or corporation rather than funding from many sources) and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs."[18]
Private Non-Operating Foundation	"A private foundation that is neither a private operating foundation nor an exempt operating foundation[19] is sometimes referred to as a grant-making foundation or a private nonoperating foundation."[20]

[17] *Types of Foundations*, I.R.S. (Aug. 17, 2022), https://www.irs.gov/charities-non-profits/private-foundations/types-of-foundations.
[18] *Public Charities*, I.R.S. (June 16, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/public-charities.
[19] "In general, an exempt operating foundation is a private foundation that has been publicly supported for 10 years; whose governing body consists of individuals less than 25 percent of whom are disqualified individuals and is broadly representative of the general public; and has no officer who is a disqualified individual during the year." *Exempt Operating Foundations*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/exempt-operating-foundations.
[20] *Grant-Making Foundations*, I.R.S. (Aug. 2, 2022), https://www.irs.gov/charities-non-profits/private-foundations/grant-making-foundations.

Term	Definition
Private Operating Foundation	"A private operating foundation is any private foundation that spends at least 85 percent of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of its exempt activities (the income test)."[21] "A private operating foundation is not subject to the tax on net investment income if it is an exempt operating foundation. In addition, private foundations may make grants to exempt operating foundations without complying with the expenditure responsibility requirements. In general, an exempt operating foundation is a private foundation that has been publicly supported for 10 years; whose governing body consists of individuals less than 25 percent of whom are disqualified individuals and is broadly representative of the general public; and has no officer who is a disqualified individual during the year."[22]
Public Charity	One of two classes of 501(c)(3) organizations, along with Private Foundations. "Generally, organizations that are classified as public charities are those that: • Are churches, hospitals, qualified medical research organizations [acting] with hospitals, schools, colleges and universities, • Have an active program of fundraising and receive contributions from many sources, including the general public, governmental agencies, corporations, private foundations or other public charities, • Receive income from the conduct of activities in furtherance of the organization's exempt purposes, or • Actively function in a supporting relationship to one or more existing public charities [i.e., a Supporting Organization]."[23]
Self-dealing	"The following transactions are generally considered acts of self-dealing between a private foundation and a disqualified person: • Sale, exchange, or leasing of property, • Leases (but see Certain Leases, under Exceptions to Self-Dealing) • Lending money or other extensions of credit, • Providing goods, services, or facilities, • Paying compensation or reimbursing expenses to a disqualified person, • Transferring foundation income or assets to, or for the use or benefit of, a disqualified person, and • Certain agreements to make payments of money or property to government officials. In addition, the law prohibits indirect self-dealing. Thus, transactions between organizations controlled by a private foundation may also be taxable self-dealing."[24]

[21] *Definition of Private Operating Foundation*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/definition-of-private-operating-foundation.

[22] *Exempt Operating Foundations*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/exempt-operating-foundations.

[23] *Public Charities*, I.R.S. (June 16, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/public-charities.

[24] *Acts of Self-Dealing by Private Foundation*, I.R.S. (May 4, 2022), https://www.irs.gov/charities-non-profits/private-foundations/acts-of-self-dealing-by-private-foundation.

Term	Definition
Type I Supporting Organization	"A supporting organization is classified as a Type I, Type II or Type III supporting organization based on the type of relationship it has with its supported organization(s). . . . A Type I supporting organization must be operated, supervised or controlled by its supported organization(s), typically by giving the supported organization(s) the power to regularly appoint or elect a majority of the directors or trustees of the supporting organization. The relationship between the supported organization(s) and the supporting organization is sometimes described as similar to a parent-subsidiary relationship."[25]
Type II Supporting Organization	"A Type II supporting organization must be supervised or controlled in connection with its supported organization(s), typically by having a majority of the directors or trustees of the supported organization(s) serve as a majority of the trustees or directors of the supporting organization. The relationship between the supported organization(s) and the supporting organization is sometimes described as similar to a brother-sister relationship."[26]
Type III Supporting Organization	"A Type III supporting organization must be operated in connection with one or more publicly supported organizations. All supporting organizations must be responsive to the needs and demands of, and must constitute an integral part of or maintain significant involvement in, their supported organizations. Type I and Type II supporting organizations are deemed to accomplish these responsiveness and integral part requirements by virtue of their control relationships. However, a Type III supporting organization is not subject to the same level of control by its supported organization(s). Therefore, in addition to a notification requirement, Type III supporting organizations must pass separate responsiveness and integral part tests."[27]
Unrelated Business Taxable Income (UBTI)	"Even though an organization is recognized as tax exempt, it still may be liable for tax on its unrelated business income. For most organizations, unrelated business income is income from a trade or business, regularly carried on, that is not substantially related to the charitable, educational, or other purpose that is the basis of the organization's exemption. An exempt organization that has $1,000 or more of gross income from an unrelated business must file Form 990-T. An organization must pay estimated tax if it expects its tax for the year to be $500 or more."[28]

[25] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.
[26] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.
[27] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.
[28] *Unrelated Business Income Tax*, I.R.S. (Aug. 2, 2022), https://www.irs.gov/charities-non-profits/unrelated-business-income-tax.

CHAPTER 1: INTRODUCTION

The Internal Revenue Code and Regulations encourage and influence charitable giving and activities by providing tax incentives and strict rules with respect to contributions and uses of monies and assets transferred to or for the use of charitable organizations and activities.

This book is intended to provide an intermediary and advanced summary of these rules as they apply to affluent donors and those who are involved with what can occur on the charitable playing field.

This book is intended to be a practical and readable resource for professional advisors and dedicated charitable entity officers and employees, but does not cover many basic items, such as all of the nooks and crannies that exist for income tax purposes when an individual or business entity makes a charitable contribution, or all of the different types of charitable entities that may be used for tax and general charitable purposes.

A. Charitable Tools and Primary Rules

By very brief summary of the primary income tax rules relating to charitable giving, the above-the-line deduction of $300 per individual/$600 per married couple charitable deduction that was permitted in 2020 and 2021 and did not require itemization, was not extended to 2022 or thereafter.

However, individuals who itemize their deductions and therefore have more than $13,850 in itemized deductions, if single, or $27,700 if married, for 2023 can deduct charitable contributions.

The itemized deductions include deductions permitted for real estate taxes (not exceeding $10,000 per taxpayer or jointly filing married couple), certain types and amounts of interest paid on a home and second home, medical and dental expenses exceeding 7.5% of the taxpayer's adjusted gross income, charitable contributions, qualified long-term care insurance premiums,[29] certain casualty and theft losses, job expenses, and the miscellaneous deductions (limited to 2% of adjusted gross income).

Many affluent taxpayers "bunch their deductions" by donating to charity every 2, 3, or 4 years instead of annually to exceed the standard deduction amount in the years they make transfers to charities.

[29] I.R.C. § 213(d)(10).

For example, a single individual who would normally give $10,000 per year to charity and has only $11,000 in itemized deductions other than charity could give $30,000 in 2023 to a donor-advised fund or other charity. The donor would have total deductions of $41,000 ($27,150 more than the individual itemized deduction amount of $13,850) to save $10,045 in federal income taxes if he or she is in the 37% bracket.

The donor advised fund may transfer $10,000 per year to Public Charities selected by the individual, and the individual may give another $30,000 to the donor advised fund in year 4.

In addition to income tax savings there can be significant income tax savings or deferral if and when an IRA or pension or ordinary income vehicle is made payable to a 501(c)(3) organization or a charitable remainder trust.

Additionally, a "complex trust" can pay all of its income to a charity and receive the equivalent of a 100% income tax deduction without regard to its adjusted gross income or the adjusted gross income of the grantor of the trust or its non-charitable beneficiaries.

The $105,000-per-year-per-donor (formerly $100,000 and now adjusted for inflation each year beginning in 2024) "Qualified Charitable Distribution IRA Transfer Exception" allows charitable transfers to count towards the minimum distribution requirements in a tax-free transfer of IRA monies or assets directly from an IRA to a Public Charity or Private Operating Foundation (but not to a donor-advised fund) by an IRA holder who is at least 70½ years old. The SECURE 2.0 Act, which was enacted in December 2022, permits a taxpayer to make a one-time up to $50,000 distribution directly from an IRA or IRAs to a charitable remainder trust or a charitable annuity and to make a one-time election to treat the contributions as if they were qualified charitable distributions made directly to a charitable entity. The $50,000 counts towards the taxpayer's $100,000-per-year qualified charitable distribution limit. Unlike a direct charitable contribution, contributions to a split-interest entity benefit not only the charity but also the individual IRA owner. The overall economic impact is that at least a small portion of what is transferred goes to charity and up to 90% of the economic value of what is transferred (up to approximately $45,000) can be paid out to the individual IRA owner over a selected term of years, not exceeding 20 years, or for his or her lifetime.

This strategy helps many affluent charitable IRA owners eliminate the corresponding amount of otherwise taxable income from their tax returns, in addition to lowering their AGI threshold and potentially pushing them into a lower overall tax bracket.

While many donors give cash to charitable organizations, it is normally advantageous to give appreciated assets that would otherwise be subject to capital gains tax if sold personally.

In general, the gift of an appreciated asset to a charitable organization will result in an income tax deduction based upon the tax basis, and not the fair market value, of the asset given, unless one of several exceptions apply.

The rules may work differently when the donation is to a particular kind of charitable organization. The discussion of the various kinds of charitable organizations is set forth below, but in general, Public Charities and Private Operating Foundations enjoy the best and same treatment for donations of appreciated assets, while Private (Non-Operating) Foundations do not enjoy as favorable of treatment in many situations.

A simplified explanation follows:

1. Appreciated securities that qualify as long-term capital gain property may be donated to a Private Foundation, Private Operating Foundation, or a Public Charity for a fair market value income tax deduction of up to 20% of the adjusted gross income (AGI) of the donor if the donation is to a Private Non-Operating Foundation, or up to 30% of AGI for donations to Private Operating Foundations or Public Charities.

   The donation of appreciated assets to a Private Operating Foundation or Public Charity will normally qualify for a tax deduction up to 30% of AGI, versus the 20% threshold that applies to appreciated securities transferred to a Private Foundation, with the same 5-year carryover provision.

2. If the donation exceeds the 20% or 30% threshold, the excess can be carried over for up to 5 subsequent calendar years.

3. Marketable securities are the only category of appreciated assets that yield a fair market value deduction when donated to a Private Foundation.

   Donations to Private Foundations of long-term capital gain assets other than marketable securities are deductible at basis and may only offset a maximum 20% of AGI each year.

4. Appreciated jewelry, physical artwork, and other tangible non-real-estate assets can be donated and deducted at fair market value, whether to a Private Foundation, a Private Operating Foundation, or a Public Charity if the assets are donated for the charity's use that is related "to the purpose or function constituting the basis for its exemption."[30]

   Artwork donated by the Artist or by an individual who received the artwork as a gift from the Artist is deductible only to the extent of actual direct costs of making the artwork.

   Many donors take advantage of the 20% or 30% capital gains donation limitation set forth above (20% for a Private Non-Operating Foundation, 30% for a Private Operating Foundation or Public Charity), and then donate cash up to another 20% for a Private Operating Foundation or Public Charity for a total of 50% of AGI.

   Cash donations to a Private Operating Foundation or Public Charity may offset 60% [3] of the donor's adjusted gross income, but this cannot be "stacked" over appreciated assets or other non-cash assets that have been donated. The appreciated asset donation above and beyond the donation of 60% of AGI in cash for a given year may be carried forward for up to 5 years.

5. This is why jewelry given to universities and other charities is often displayed, so as to be considered as used by the charitable organization, and why collections of cars, airplanes,

[30] I.R.C. § 170(e)(1)(B)(i).

or other valuable tangible assets are commonly given to museums that will display them (or instruct foundations to loan them to museums) for enjoyment by the general public.

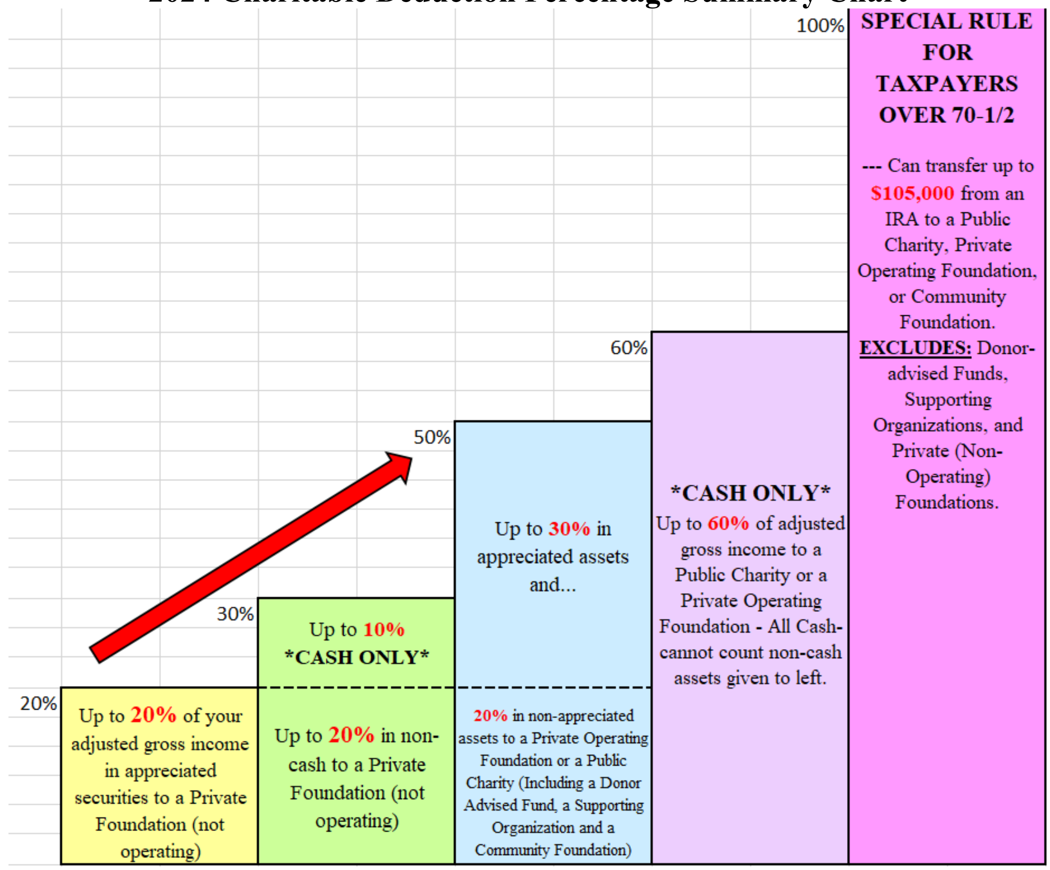
6. Appreciated real estate and assets other than marketable securities may be donated to a Private Operating Foundation or Public Charity for a fair market value deduction, except to the extent that ordinary income would be recognized on the sale of the property. This occurs, for example, when IRC § 179 deduction was taken as "component depreciation" when the property was acquired or improved.

7. Notwithstanding that a fair market value deduction may be permitted under the rules above, a taxpayer may *elect* to deduct the basis of the property instead of its fair market value to eliminate the 20% or 30% limitations above to instead trigger a 50% of AGI limitation apply, as discussed below.

   For example, donations of long-term capital gain assets are valued at fair market value and may be deducted to the extent of 30% of AGI when made to a Private Operating Foundation.

The Five-Dimensional Charitable Plan				
A Noble Cause(s)	Tax Savings	Recognition	Who Is Involved?	Desire for Control and Security
1. Helping children. 2. Defending rights. 3. Helping the elderly. 4. Assisting with education. 5. Supporting Israel. 6. Helping animals. 7. Helping the environment. 8. Helping your hometown. 9. Helping your school. 10. Scholarship funds. 11. Shelter for single mothers. 12. Helping the homeless. 13. Helping immigrants. 14. Helping homeless Ukrainians. 15. Curing cancer. 16. Curing Parkinson's disease. 17. Helping your church, synagogue, or mosque.	1. Tax deduction—December 31 year end. 2. Getting above 50% AGI—income-producing assets transferred to charity for complex trust. 3. The liquidity event: A. Transfer to CRT before sale. B. Transfer to charity before sale. C. Place in tax-deductible CLAT before sale. 4. The $100,000 IRA Qualified Charitable Distribution (QCD) by year end. 5. Avoid federal estate tax—CLAT now or later.	1. We have our own family foundation. 2. Recognition by local or national organizations. 3. Involvement & opportunity to recognize spouse and family. 4. Naming buildings and parts of buildings. 5. Sponsoring matching fund. 6. Hosting fundraiser parties and events. 7. Would your parents be proud?	1. Spouse. 2. Children. 3. Community (recognition). 4. Charitable professionals. 5. Tax advisors. 6. Financial advisors. 7. Estate planning advisors. 8. Life insurance advisors. 9. Clergy. 10. National Public Radio and local affiliates. 11. Appraiser, if hard-to-value assets contributed.	Control—may control: 1. Private Foundation. 2. Account under donor advised fund. 3. Scholarship fund decisions. Security: 1. May earn salary working for foundation. 2. May receive stream of payments from charitable remainder trust. 3. Family members may receive significant assets from a CLAT after a term of years.

2024 Charitable Deduction Percentage Summary Chart



Special Notes:

1. Donations to charitable remainder annuity trusts (CRATs) and charitable remainder unitrusts (CRUTs) may generate deductions in the same categories as shown on this chart.

2. A C corporation[31] can deduct up to 10% of its taxable income. If a C corporation's charitable contributions in a tax year exceed this limit, the excess can be carried over to 5 subsequent tax years, subject to the same 10% limitation in each of those subsequent tax years.

3. Undesignated assets remaining at death do not qualify for an income tax deduction but can save income taxes on "income in respect of a decedent" (IRAs, pension accounts, variable annuities, etc.).

4. Standard Deductions:

    a. 2024 single individual: $13,850

[31] A C corporation is a corporation that is taxed as a separate entity and pays income tax on its net income. Different rules apply to S corporations, which normally reports the corporation's report income and deductions on K-1 Forms K-1 that to transfer those items of income and deduction to each shareholder's the personal or income tax returns of individual shareholders and with respect to other entity's tax return entities that have ownership.

   b. 2024 married couple: $27,700

   c. 2024 heads of household: $20,800

5. IRA owners may designate charitable remainder trusts as beneficiaries to stretch out distributions to non-charitable beneficiaries over as many as 20 years, with the remainder passing to charity at the end of the 20th year.

B. <u>The Selection of Charitable Entities</u>

Any 501(c)(3) organization may receive non-business income on a tax free basis, including dividends from C corporations, most forms of passive rental income, interest income, and non-dealer capital gains. Donations to any 501(c)(3) organization can qualify for the charitable income tax deductions.

A Public Charity most commonly refers to a 501(c)(3) organization that receives a significant amount of its support (33 1/3% or more) from donors who contribute 2% or less of the income of the organization, or organizations that receive significant support (66 2/3% or more) from combined donors who contribute 2% or less of income and general operations such as operating a profitable museum or charter school.[32]

Other Public Charities include certain schools, medical research organizations, churches and organizations of churches, hospitals and medical treatment centers ("clinics") that qualify as "hospitals," even when these organizations are funded and controlled by one person or family.

Public Charities also include Donor Advised Funds and Community Foundations.

Public Charities enjoy two primary categories of advantages:

1. Public Charities and Private Operating Foundations both enjoy the best income tax treatment for donors who wish to gift either non-traditional appreciated assets or marketable securities. Donors receive an income tax deduction of up to 30% of AGI for gifting appreciated assets and up to 60% of AGI for cash donations.

   Contributions exceeding these limits may be carried over for up to 5 successive tax years.

2. Public Charities (excluding Private Operating Foundations) enjoy these additional advantages:

   a. The self-dealing rules do not apply to Public Charities, so they may enter into certain arm's length transactions with donors and contributing parties.

   b. Public Charities are not subject to the 1.39% tax on annual income tax imposed on Private Foundations and Private Operating Foundations.

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[32] There is an exception to the limits that otherwise apply to public charities that receive large donations that exceed 2% of income under certain circumstances.

c. Public Charities are not subject to the rules that require minimum distributions, use of assets, or expenditures of 4.25% of the asset value of a Private Operating Foundation every 3 out of 4 years or approximately 5% of the non-charitable assets of a Private Non-Operating Foundation each year.

   Private Operating Foundations must remain active rather than simply operating as a passive investment and grant-making (grant-making = gift giving) organization. It is noteworthy that scholarship arrangements may be considered a qualified activity for Private Operating Foundations for families that wish to have the tax advantages and recognition of a Private Operating Foundation for the primary purpose of actively interviewing, awarding, monitoring, mentoring, and commending scholarship recipients.

d. Public Charities include Supporting Organizations, which can own and manage investments and endowments separate from the charitable organization and qualify as a Public Charity if the supported charitable organization is a Public Charity.

All 501(c)(3) Organizations can have issues with the following rules:

1. <u>Unrelated Business Taxable Income (UBTI)</u>—Any income from S corporation stock or an entity taxed as a partnership results not only in a corporate or trust level tax but also possible disqualification of the organization from being a charity if it receives too much UBTI. UBTI does not include income from C corporations or underlying C corporation activities, and dividends paid from a C corporation to a charitable organization are tax free.

2. <u>Private Inurement</u>—501(c)(3) organizations must benefit charitable purposes and not significantly benefit individuals, donors, or certain or other non-charitable causes, with very few exceptions.

3. <u>The Excess Business Holdings Rules</u>—These rules prevent a 501(c)(3) organization from owning more than 20% of the voting stock of a company, after application of very broad related party rules, which can often be avoided by careful planning. It is permissible to place all voting interests (perhaps 1%) in a 35/65 Trust (see Chapter 4 and IRC § 4946(a)(1)(g)) and then to gift non-voting member interests to obtain a tax deduction for the transfer while not violating the excess business holding rules. An exception to the Excess Business Holdings Rules allows a charitable organization to hold ownership for up to 5 years from receipt in many situations.

Chapter 2 provides further explanation of the various charitable organizations available for charitable planning and explains the requirements that must be satisfied to create and maintain these organizations.

C. <u>Choice of Business and Investment Entities with Charity in Mind</u>

Much can be written about the advantages and disadvantages of using different kinds of entities for business and investment purposes. The factors to be considered can vary significantly depending on a client's situation. This is a very simplified discussion intended for individuals who have little or no tax background.

Business and investment entities are normally taxed and characterized as being one or a combination of the following:

- Individually-owned entities or entities under limited liability companies that are "disregarded" for income-tax purposes,

- S corporations or limited liability companies that elect to be treated as S corporations,

- Partnerships or limited liability companies that desire to be treated as partnerships, or

- C corporations.

Basic information with respect to the above is as follows:

1. Disregarded Entities and Individual Ownership

Individual ownership or ownership by a married couple or an LLC that is disregarded and owned by an individual or a married couple will be reported on the Form 1040 of the individual or married couple at Schedule C for a business, Schedule E for rental activities, or Schedule F for farming.

The net income will normally be subject to employment taxes, and charitable contributions made by the business or LLC will be considered to be individual charitable deductions.

Because an LLC is disregarded for income tax purposes, whatever it gives and whatever it does is considered to be given and performed by the owner thereof for income tax purposes.[33]

2. S Corporations

S Corporations are by far the most popular vehicle for profitable business entities.[34] S corporations are generally not subject to federal income tax, but instead report their taxable income

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[33] *Single Member Limited Liability Companies*, IRS (last reviewed or updated Aug, 2, 2023), https://www.irs.gov/businesses/small-businesses-self-employed/single-member-limited-liability-companies.

[34] According to tentative statistics published by the IRS, in 2018 there were 4,874,996 S corporation tax filings, 2,821,394 limited liability company tax filings, 1,509,775 C corporation tax filings, and 974,308 partnership filings. Jacob Tingen, *Business Structure Statistics: IRS Data on Business Entity Types [1980-2018]*, Tingen Law, PLLC (Mar. 31, 2022), https://tingen.law/2022/business-structure-statistics/. Note as well that sole proprietorships are the most popular business structure in the United States (the IRS reported over 25 million sole proprietorships in 2015), however a sole proprietorship is simply an individual who solely owns a business that has not been incorporated. For tax and liability purposes, in the eyes of the law there is no difference between the sole proprietorship and the individual owner.

and deductions to the shareholders, who then include the income and deductions on their personal Form 1040 tax returns. The S corporation gives K-1 Forms to the shareholders to facilitate this.

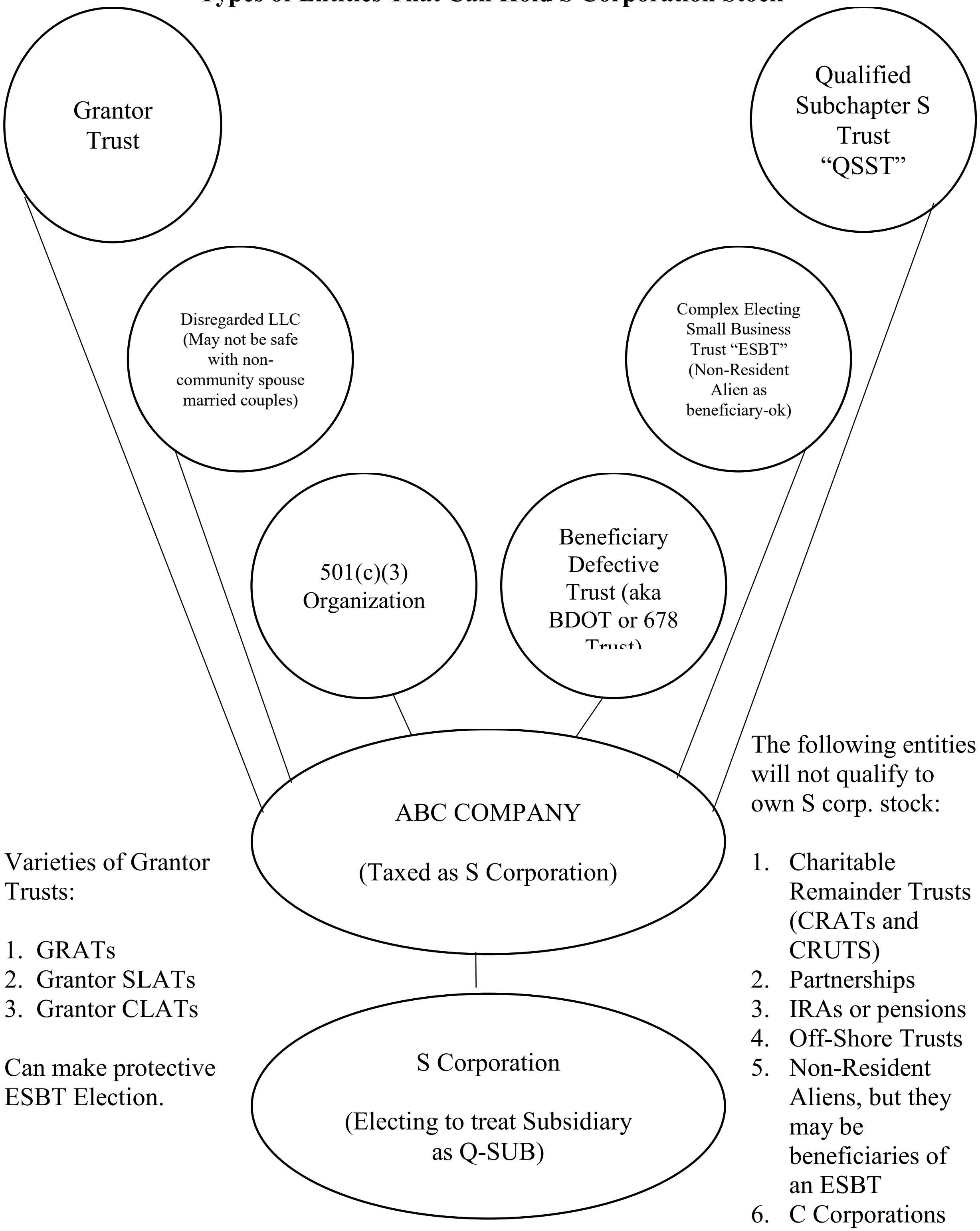
Shareholders are generally not subject to employment taxes or the 3.8% Medicare tax on S corporation income, but shareholders may also receive wages or other compensation payments that will be subject to employment taxes.

The above tax treatment is similar to what applies to entities taxed as partnerships, except that the S corporation rules can be much stricter because all income and ownership rights have to allocated strictly pro rata to ownership, without having any sort of preferred or common interests or rights as between the owners, other than the differing voting rights, which are permitted. Also, partners will generally be subject to employment tax on all partnership income if they work for the partnership.

A charitable donation made by an S corporation will be reported on the K-1 Forms so that each shareholder can include the shareholder's pro rata share of the contribution on the shareholder's personal or trust income tax return, as applicable.

S corporations must generally be owned by individuals or certain kinds of trusts, or 501 (c)(3) organizations, as summarized on the chart that follows.

Types of Entities That Can Hold S Corporation Stock



It is noteworthy that limited liability companies can qualify for S corporation treatment if properly formed and documented. Therefore, the members of an LLC taxed as an S corporation will be treated as "shareholders" under the rules described above, if all LLC documents are consistent with the S corporation rules (be careful!).

Fortunately, 501(c)(3) organizations can receive and own S corporation stock, subject to a number of rules that are described in this book and summarized in EZ Learning Chart C, *Ownership of S Corporation Interests*, at the beginning of this book. Some of the charitable rules that can make S corporations less attractive than partnerships, C corporations, and outright ownership are as follows:

a. S corporation K-1 income that is reported by a 501(c)(3) organization is subject to income tax at the 100% bracket, and any income from the sale of an S corporation interest, including a redemption, is also subject to income tax at the 100% bracket.

b. S corporations stock cannot be owned by a charitable remainder trust.

c. The conveyance of assets by an S corporation to a 501(c)(3) charity or a charitable remainder unitrust can trigger income tax liability at the level of the S corporation owners if "substantially all" of the assets of the S corporation are conveyed to charity.[35] The same rule applies to C corporations.

d. If a C corporation converts to an S corporation there can be a corporate level tax and a tax to the shareholders/members on the sale of assets that were in existence and had a greater value than their tax basis on the date of the conversion, pursuant to the unrecognized built-in gain rules and IRC § 1374.

3. Entities Taxed as Partnerships

Entities that are taxed as partnerships are similar in many ways to S corporations, but the partnership tax law can be more flexible to allow the allocation of income and deductions other than pro rata to ownership if certain complicated rules are followed.[36] Like S corporation stock, partnership ownership interests can be owned by 501(c)(3) organizations. Unlike the S corporation rules, a partnership interest can be owned by a charitable remainder trust, but income reported by the charitable remainder by reason of K-1 reporting from the partnership will be taxed at the 100% bracket!

Trusts that are separately taxed as "complex trusts" may deduct their share of partnership charitable contributions if the trust owns a partnership interest and the partnership donates to charity, regardless of whether the trust agreement explicitly provides for charitable donations. This can be important because trusts themselves can generally not receive a charitable deduction for distributions made to charity unless such a provision exists in the original trust agreement.

Sometimes LLCs and limited partnerships will be structured to have 90% or less of the ownership interests held as "preferred interests" that will pay a minimum rate of return, and common interests that may be worth 10% or more of the value of the entity upon inception and

[35] Treas. Reg. § 1.337(d)-4 (2018).
[36] I.R.C. § 704(b) (substantial economic effect rules).

will receive most of the appreciation in excess of the preferred interest's rate of return. A preferred rate of return may be between 8% and 9% when the IRC 7520 rate is between 4 and 5%, assuming that preferred interest holder has made a significant contribution. The donation of a preferred partnership interest to a Charitable Lead Annuity Trust could result in sufficient payments from the partnership to satisfy annual CLAT charitable payments and complete ownership of the preferred interests at the end of the charitable lead trust charitable term.

Basic Income Tax Operations

Shareholder (Dividends are taxed)	Shareholder (Dividends are not taxed)	Partners (Individuals, S corporations or otherwise) (Distributions are not taxed)	
C CORP TAXED ENTITY	S CORP TAXED ENTITY	PARTNERSHIP TAXED ENTITY	SOLE PROPRIETOR (DISREGARDED ENTITY)
• Entity is taxed for income at 21%; shareholders taxed for dividends and distributions. • Corporate level tax–revenues minus deductible expenses • Contribution of appreciated assets can trigger tax unless the 80% rule is followed under IRC Section 351. • Income is triggered if an appreciated asset or accounts receivable are transferred from the C corporation to shareholders unless it is deductible compensation.	• Owners are taxed at individual rates for salary and income of the company. • Income and deductions are computed and then go on income tax returns of owners by K-1 reporting. • Contribution of appreciated assets can trigger tax unless the 80% rule is followed under IRC § 351. • Income is triggered if an appreciated asset or accounts receivable are transferred from the S corporation to shareholders unless it is deductible compensation.	• Income and deductions are computed and then go on income tax returns of owners by K-1 reporting—no entity-level tax. • Distributions to partners are usually subject to employment taxes. • Compensation paid to partners is often called "guaranteed payments" and reduces partnership income. • Typically no income tax is triggered when appreciated assets are contributed to the partnership in exchange for a	• All income and deductions are shown on individual's Form 1040 Schedule C—subject to employment taxes of 12.4% on the first $137,700 of income, plus the 2.9% Medicare tax, making for a 15.3% tax thereon, plus the 2.9% Medicare tax on income from $137,700 and an additional 0.9% Medicare tax to the extent of self-employment income that exceeds $200,000 for a single taxpayer and $250,000 for a married taxpayer.

• Dividends are not deductible expenses. • May deduct healthcare and disability insurance expenses under certain circumstances. • In the highest individual tax bracket on the first dollar of income if this is a personal service company.	• Special rules apply if an S corporation used to be a C corporation. This can cause double tax. • Shareholder might be afforded the benefit of the 20% § 199A deduction.	partnership interest. • Typically no gain is triggered when the partnership transfers appreciated assets to its partners to redeem their ownership interests. • Partner might be afforded the benefit of the 20% Section 199A deduction.	• Owner might be afforded the benefit of the 20% Section 199A deduction.

4. Entities that are disregarded for income tax purposes

An investor or entrepreneur who owns businesses or investments under an LLC that is disregarded for income tax purposes will have significant freedom, as set forth in the above chart, *Basic Income Tax Operations*.

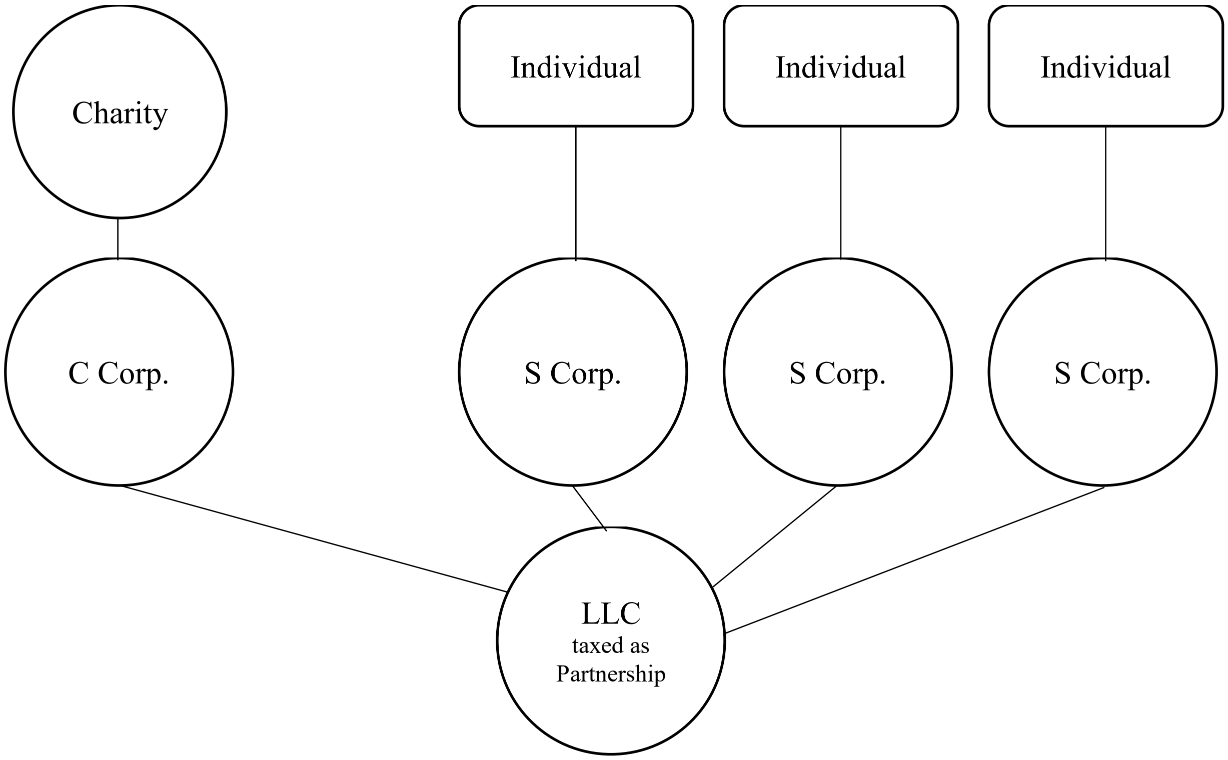
5. C Corporations

C corporations are taxed on net income, and the shareholders of C corporations are generally taxed again when dividends are distributed. This tax on dividend distributions generally does not apply to 501(c)(3) organizations.

It is therefore common for 501(c)(3) organizations to request or require that any ownership interest in an investment or business entity must be in the form of a C corporation.

This can be detrimental to the individual owners of the entity, who may prefer S corporation status.

When the underlying entity is taxed as a partnership, it is possible to have the individual owners hold their partnership interests directly or through S corporation that they may own. The charity may receive or form a C corporation that in turn owns the partnership interests to shield it from having to pay tax on K-1 income. The C corporation pays the tax instead, and the 501(c)(3) organization is spared from having to report and pay tax on unrelated business taxable income or to be concerned that it will not have sufficient cash to pay the taxes on the income reported to it—although the C corporation may have the same problem. Below we see a chart that shows a charity owning a C corporation and individuals owning S corporations. The C corporations and S corporations can own an LLC that is taxed as a partnership so that the charity does not have to pay tax on its income and the individuals will have flow-through tax treatment.



D. An Abbreviated Charitable Planning Checklist

The following checklist provides some of the most important strategies and vehicles to consider when planning with respect to charitable giving:

1) The $105,000 per year IRA to Charity Rule

   a) Transfer up to $105,000 per year directly from an IRA to a Public Charity or a Family Operating Foundation if the IRA owner is over 70½ years old. This counts toward any minimum distribution requirements. See "Self-Directed IRAs" in Chapter 3 for further explanation.

   b) Under the 2022 SECURE 2.0 Act each taxpayer who has reached age 70½ may transfer up to $50,000 from his or her IRA account to a charitable remainder trust or to fund a charitable annuity while satisfying up to $50,000 of the taxpayer's minimum distribution requirement, as further discussed.

2) Using a Charitable Trust to avoid Income Tax after Death

   An IRA or pension account owner can make a charity or Charitable Remainder Trust the "pay on death beneficiary" or contingent beneficiary to eliminate or defer income tax on distributions after death. See "Self-Directed IRAs" in Chapter 3 for further explanation.

3) Gifting Capital Assets to Charity

Appreciated capital gains assets, like stock or real estate, can be gifted to a Public Charity or Private Operating Foundation to obtain an income tax deduction based upon the fair market value on what is transferred. This will also work for publicly traded stocks and mutual funds that are transferred to a Private Foundation. An amount equal to up to 30% of adjusted gross income can be deducted each year. This is 20% of adjusted gross income if the donation is to a Private Non-Operating Foundation, but the donation must be of marketable securities, unless the taxpayer elects to deduct the income tax basis instead of fair market value of the appreciated marketable securities. Additional amounts can be given in cash to reach up to 50% of adjusted gross income if appreciated capital gains assets are given. Alternatively, cash-only gifts to Public Charities and Private Operating Foundations can be deducted up to 60% of adjusted gross income. See "Charitable Tools and Primary Rules" in Chapter 1 for further explanation.

4) Contributions and Bunch Deductions

In order for individual contributions to exceed the standard deduction, bunch deductions by making charitable donations every second, third, or fourth year. For 2024, each individual taxpayer filing a return has a standard deduction of $14,600 for a single person and $29,200 for a married couple filing jointly. The annual property tax deduction cannot exceed $10,000. Medical expenses only count to the extent exceeding 7.5% of adjusted gross income. Interest deductibility is subject to various limitation rules. A taxpayer who would like to donate $10,000 per year to charity could donate $50,000 to a Donor Advised Fund, Community Foundation, or a Private Operating or Non-Operating Foundation to receive a tax deduction for amounts exceeding the standard deduction and then use the gifted entity to make annual charitable gifts. See "Supporting Organizations and Creditor Protection for Charitable Organizations" in Chapter 2 for further explanation.

5) Avoiding Tax on Assets through an Irrevocable Trust

For taxpayers who already use the full 50% or 60% of adjusted-gross-income deduction and/or taxpayers who wish to avoid the 3.8% Medicare Tax, consider placing income-producing assets into an irrevocable trust that can pay some or all of its income directly to charity so that the income will not be taxable. See "Planning with the IRC § 1411 Medicare Tax" in Chapter 3 for further explanation.

6) Sponsorship

In addition, businesses may pay for advertising and become "sponsors" of a charitable organization's activities and receive an income tax deduction under IRC § 162 for reasonable and necessary business expenses.

7) Transferring Interest in Real Property

A home or farm owner may transfer a remainder interest in a residence or farm and receive an income tax deduction for the present value of the remainder interest, while retraining the right to use the home or farm rent-free for the remainder for his or her lifetime. The life estate holder may thereafter decide to donate the life estate rights to charity in order to receive an additional income tax deduction. See "Receiving a Charitable Deduction for the

Contribution of a Remainder Interest in Personal Residence or Farm" in Chapter 3 for further explanation.

8) Gifting Appreciated Collectibles

Give appreciated artwork, jewelry, or other collectables to a charity that can use or display them to obtain an income tax deduction based upon what a retail store would charge for such items (in used condition). See the chart entitled "Outright Gifts" at the beginning of Chapter 3 for further explanation.

9) Contributing to Social Welfare Organizations

Taxpayers who wish to support political causes and have appreciated assets that may be sold should consider contributing those assets to an IRC § 501(c)(4) Social Welfare Organization to avoid paying income tax on the sale of appreciated assets and income subsequently derived thereon. 501(c)(4) organizations are subject to tax on unrelated business taxable income. See "The 501(c)(4) Strategy" in Chapter 3 for further explanation.

10) Alternative Methods For Retaining "Fruit From The Tree"

a) Other methods of obtaining recognition, a locked-in benefit for charity, and an income tax deduction for the donor who may retain the right to the "Fruit From The tree" or more are available through the following, which are discussed in further detail throughout Chapter 2:

i) Pooled Income Fund: Transfer money or appreciated assets to charity in exchange for the right to participate in the income from a designated "pool" of assets based upon the charity's adherence to IRS guidelines.

ii) Fund a Charitable Gift Annuity by giving cash or appreciated assets to the charity in exchange for receiving a stream of payments, which may begin immediately or after a given term. The donor receives an income tax deduction and the charity may spend some of the money received for charitable purposes and use the rest to purchase a commercial annuity contract to ensure that the charity will have the exact amounts needed to satisfy the annuity payment obligation.

iii) Consider a tax-neutral dedicated non-qualifying charitable trust if a family wants to commit a certain amount of assets for charitable purposes without having the cost and complexity of a 501(c)(3) organization. A tax-neutral dedicated charitable trust can be held for both charitable and non-charitable purposes to provide a family identity and to "try a family foundation on for size" before committing to 501(c)(3) status.

iv) A donor administered or controlled Charitable Remainder Trust (CRT) can also provide the donor with deferral of income tax on the sale of appreciated assets transferred to the CRT before the appreciated assets are sold, in addition to annual payments that may be made for up to 20 years or for the lifetime or joint lifetime of one, two, or three individuals. The donor receives an income tax deduction for part of the value of the assets contributed. Alternatively, it is possible to structure a charitable remainder trust so there is no income tax deduction or gift tax deduction. Under the Internal Revenue Code, the self-dealing rules will not apply between the donor and the CRT if no such income tax or gift tax deduction existed, so that the donor can borrow money from the CRT and pay arm's length tax deductible interest that will not be taxable to the CRT, and will also not be taxable to the taxpayer or the CRT beneficiaries until distributed.[37]

b) Inventory and short-term capital gains assets can be transferred to a charitable remainder unitrust to facilitate deferral of income tax, but there will be no income tax deduction with respect to the remainder interest attributable to non-long-term capital gain property transferred.[38]

c) As an alternative to a CRT, a donor may consider making a transfer to a Pooled Income Fund that is operated by a charity in exchange for the right to receive income from the Pooled Income Fund for the lifetime of the donor. Another alternative is to purchase a Deferred Gift Annuity where the charity may invest some of the money that it receives in a commercial annuity contract to ensure that it can make the promised payments to the donor, while using excess funds for the charitable purposes of the organization. The general rule of the thumb is that one half of the amounts transferred are considered to be a donation and one half are in consideration for the annuity payment to be received back.

d) A donor can fund a Charitable Lead Annuity Trust (CLAT) and receive an income tax deduction for putting a "tree" into the trust, while receiving back some fruit and possibly even a substantial portion of the "tree" after a term of years. Alternatively, the CLAT can be funded during the lifetime of a grantor to provide an income tax deduction and for significant value to be transferred to descendants of the grantor after one or more charities have received a stream of annual payments for a specified term of years.

e) A zeroed-out testamentary CLAT can be used to completely avoid federal estate tax while being expected to provide a significant non-estate-taxable disposition for the descendants of the donor or others after a term of years and a number of annual payments to charity. A lifetime zeroed-out CLAT can provide the same result so that the donor can receive an income tax deduction upon funding and equivalent charitable and estate tax avoidance benefits.

f) Family Private Foundation: an individual or family can form a 501(c)(3) company or trust and receive tax deduction for funding with appreciated marketable securities or cash. The foundation should transfer approximately 5% of its net worth each year to one or more public charities, or to a Donor Advised Fund under an account controlled by the family that need not be spent on charitable purposes under present law.

g) Private Operating Foundation: Similar to a private foundation, the family or donor may transfer appreciated real estate or other assets besides marketable securities to deduct up to a 30% of adjusted gross income, plus cash up to 20% of adjusted gross income.

[37] *See* I.R.C. §4941

[38] *Furrer v. Comm'r*, 124 T.C.M. (CCH) 223 (2022)

Approximately 4.25% of the net value of the operating foundation assets should be spent on charitable activities and for charitable purposes at least 3 out of every 4 years.

h) Some homeowners and some farmers will transfer the remainder interest in their home or farm to a charity to receive an immediate income tax deduction while retaining the absolute right to have continued use of the property for the lifetime of the donor.

E. Acknowledgement and Appraisal Requirements

The IRS has been quite inflexible and the tax law has been very unforgiving when certain acknowledgement and appraisal rules are not met. The result can be the loss of any and all deductions.

1. The Contemporaneous Written Acknowledgment Requirement

A charitable organization receiving a gift of $250 or more must provide a contemporaneous written acknowledgment of the gift in order for it to be deductible by the donor.

This contemporaneous written acknowledgment must include the following items:

1. A description of the property donated,
2. A statement of whether the charity provided any goods or services in consideration for the gift, and
3. A description in good faith of the value of any goods or services given to the donor by the charity.

There is no requirement that the receipt indicate or estimate the value of what was donated.

The IRS has been relentless in denying multimillion-dollar charitable deductions for taxpayers who did not receive such receipts from their own Private Operating Foundations or other charitable organizations.

Additionally, under IRC §170(f)(18)(B), to obtain a charitable deduction for charitable contributions to donor-advised funds, the required contemporaneous written acknowledgement must include a statement that the donee "has exclusive legal control over the assets contributed."[39]

In the 2023 T.C.M. opinion of *Estate of Hoensheid v. Commissioner*,[40] a taxpayer contributed shares of a company to a charitable organization just before the company was sold to a third party. The taxpayer did this to avoid taxation through a charitable income tax deduction. Among the IRS' arguments to disallow the charitable income tax deduction was that the taxpayer

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[39] *Est. of Hoensheid v. Comm'r of Internal Revenue*, T.C.M. (RIA) 2023-034 (2023) at *35; I.R.C. §170(f)(18)(B).
[40] *Id.*

should be denied the deduction because that the taxpayer did not obtain a contemporaneous written acknowledgment under Section 170(f)(8).

The Court denied the IRS' position. Under Section 170(f)(8), the contemporaneous written acknowledgement must include, "The amount of cash and a description (but not value) of any property other than cash contributed." The IRS argued the taxpayer's contribution confirmation letter failed to meet the contemporaneous writing acknowledgment requirements because the contribution letter from the donee charitable organization described the taxpayer's contributions as shares of stock rather than cash.

According to the Court, however, "[i]t is sufficient here that the CWA provided by [the donee charitable organization] described the contributed property as shares of stock." The Court ultimately concluded that the contemporaneous written acknowledgement issued by the donee charitable organization satisfied the requirements under section 170(f)(8):

> The contribution confirmation letter issued by [the donee charitable organization] was contemporaneous, acknowledge receipt of 1,380,400 shares of [the taxpayer's former company's] stock, and contained the applicable statements required by the statute, including the "exclusive legal control" statement.[41]

2. Appraisals Required for Assets Exceeding $5,000 in Value

Unlike cash and marketable securities, if a donor claims that real property or other non-marketable assets have a value of more than $5,000, the donor must provide an appraisal issued by a qualified state-licensed appraiser who regularly appraises property of the nature being valued in order to have an income tax deduction.[42] The amounts paid for the appraisal are not considered to be a charitable deduction. Instead, they are deductible in the same manner as income-tax-preparation expenses and subject to the itemized-deduction-expense limitations under IRC § 67.

The qualified appraisal for real estate or other assets is an appraisal prepared by an individual or individuals meeting the definition of a "qualified appraiser" under Treas. Reg. § 1.170A-13(c)(5), The "qualified appraiser" must have earned an appraisal designation from a recognized professional appraisal organization or have otherwise met minimum education and experience requirements set forth under IRS regulations. The "qualified appraiser" must regularly perform appraisals for compensation, while also meeting other requirements.

[41] *Id.* at 36.
[42] *Id.* at 37.

A real estate appraiser must be licensed or certified for the type of property appraised in the state in which the property is located.

In *Hoensheid*,[43] which is discussed in subsection F-1 above, the IRS succeeded by contending that an appraisal for shares was not a qualified appraisal for purposes of claiming the charitable income tax deduction for the following reasons:[44]

- It did not include a statement that it was prepared for federal income tax purposes;
- It included an incorrect date for the contribution;
- It included a premature date of appraisal;
- It did not sufficiently describe the method for doing the valuation;
- It was not signed by the individual who prepared it;
- It did not include such individual's qualifications as an appraiser;
- It did not describe the property donated in sufficient detail, and
- It did not include an explanation of the specific basis for the valuation.

Under the doctrine of substantial compliance, if the timely prepared appraisal included with the applicable tax return discloses sufficient information for the Commissioner to evaluate the reliability and accuracy of a valuation, a court may deem the appraisal requirements satisfied. Taxpayers who fail to comply with the qualified appraisal requirements may still be entitled to charitable contribution deductions if they show that their noncompliance is "due to reasonable cause and not to willful neglect."

The taxpayer's arguments relied on the doctrines of substantial compliance[45] and reasonable cause,[46] but the Court held that the failure to comply with a substantial number of requirements[47] and lack of reasonable cause[48] prevented the taxpayer from receiving an income tax deduction. The result was a complete denial of the claimed charitable income tax deduction.

3. <u>Appraisal or Gift Tax Return Must Disclose Income Tax Basis/Cost of Donated Assets</u>

Treasury Regulation § 1.170A-13(c)(ii)(2) contains special substantiation requirements for charitable contribution deductions in excess of $5,000. The taxpayer must "[a]ttach a fully completed appraisal summary . . . to the tax return (or, in the case of a donor that is a partnership

[43] *Id.*
[44] *Id.* at 39.
[45] *Id.* at 40.
[46] *Id.* at 44.
[47] *Id.* at 43.
[48] *Id.* at 45.

or S corporation, the information return) on which the deduction for the contribution is first claimed (or reported) by the donor."

The above regulations require a fully completed appraisal summary of the appraised and donated assets in order to claim a charitable deduction on those donated assets. If an entity fails to provide the "cost or adjusted basis" of the donated property, then the IRS and courts will likely deny the charitable contribution deduction.[49]

In *Oakhill*, the Court denied Oakhill Woods, LLC (Oakhill)'s charitable contribution after an IRS audit and subsequent court proceeding. Oakhill, an LLC taxed as a partnership, claimed a charitable contribution deduction after donating a conservation easement, [50] Oakhill completed its partnership tax return by attaching to the Form 8283 a letter that stated as follows:

> A declaration of the taxpayer's basis in the property is not included * * * the attached Form 8283 because of the fact that the basis of the property is not taken into consideration when computing the amount of the deduction. Furthermore, the taxpayer has a holding period in the property in excess of 12 months, and the property further qualifies as "capital gain property."[51]

The IRS argued that the charitable contribution must be denied because Oakhill failed to attach "a fully completed 'appraisal summary'" on Form 8283 of Oakhill's 1065 U.S. Return of Partnership income.[52] More specifically, the IRS claimed Oakhill failed to report its "cost or adjusted basis" on Form 8283.

In response, Oakhill argued that Oakhill 1) strictly complied with or 2) at least substantially complied with the requirements under §170.

1. Under the strict compliance, a taxpayer must attach a fully complete appraisal summary. The Court reasoned that Oakhill intentionally left out the cost or adjusted basis and that it was too late when Oakhill gave the request information three years after the return was filed.[53] Therefore, Oakhill's appraisal summary failed to substantially comply with the charitable deduction requirements under §170.

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[49] *Oakhill Woods, LLC v. Commissioner of Internal Revenue*, 119 T.C.M. (CCH) 1144 (2020).
[50] A conservation easement is a voluntary legal agreement that permanently limits uses of land in order to protect its conversation values. *What is a conservation easement?*, NCED, https://www.conservationeasement.us/what-is-a-conservation-easement/ (last reviewed Aug. 11, 2023)
[51] *Id. at 3.*
[52] *Id.*
[53] *Id.* at 5-6.

2. Under the substantial compliance doctrine, a taxpayer must do all that is reasonably possible, but nonetheless fail to comply with the specific requirements of a provision.[54] The Court again reasoned that the attached letter to Form 8283 intentionally left out the cost basis information. Therefore, Oakhill did not do all that was reasonably possible to comply with the charitable contribution deduction requirements.

As a result, the Court denied Oakhill's charitable contribution deduction of $7,949,000 (or $20,975 per acre). Considering the above case, it is important to properly disclose the "cost or adjusted basis" of a donated asset on a tax, return if the taxpayer wants to properly claim a charitable contribution deduction.

F. When is Real Estate Considered to be Transferred?

Real estate is considered to be transferred to a charity at the time it becomes owned by the charity under state law. Under the law of most states, a transfer occurs when a deed is duly signed, witnessed, notarized, and physically delivered to the donee, or recorded in the public records.

The recording of a deed certainly proves that ownership was delivered on or before the date of recording, but is generally not determinative of the time of the transfer. For example, the United States Tax Court approved a contract-for-deed arrangement where the taxpayer sold real estate to a charity in a bargain sale in which the charity was required to pay the purchase price over time. The court found that the transaction was complete for income tax purposes when the contract for deed was signed, and that there was an unconditional obligation on the part of the taxpayer to deliver the deed when full payment was made.[55]

1. Consider the Nominee Agreement

State law may recognize that the ownership of an asset has transferred, even though formal retitling has not occurred. In the 1978 United States District Court for the District of Maryland opinion *In re Urban Dev. Co. & Assocs.*,[56] property was recognized to be owned by a partnership, even though it was titled in the name of the partnership's general partners.

In determining that property was owned by an entity other than the title holder, the United States District Court for the District of Maryland considered that the partnership agreement

[54] *Id.* at 6 *citing Durden v. Commissioner*, 140 T.C.M. (CCH) 1762, 1763 (2012)
[55] *Musgrave v. Comm'r*, 80 T.C.M. (CCH) 341 (2000).
[56] 452 F. Supp. 902 (D. Md. 1978).

indicated that "the purchase and development of [the property] for partnership purposes," that the partnership "filed a partnership tax return on the [property]," "that its books and ledgers reflected the assets and liabilities of the [property]," and that "the property was purchased . . . through loans . . . guaranteed by [the partnership's] limited partners."[57]

Taxpayers who own property often wish to receive an income tax deduction for the calendar year preceding the year in which the formal title of property is transferred.

It may be beneficial to provide in a charitable trust agreement or under the bylaws of a nonprofit company that the trustees, managers, or officers may hold property that is not yet registered or in the name of a nominee.

A properly drafted, signed, and effective nominee agreement that confirms that the beneficial and substantive ownership of an asset has been transferred to a 501(c)(3) organization may be sufficient if executed in the year that the donation was considered to occur.

2. What if the Property is Subject to a Mortgage?

When real estate subject to a mortgage is donated to a charity, several rules will apply. This is further explained in Chapter 4.

In short, the deduction for the transfer of property that is encumbered by a mortgage is limited to the net value of the property after reduction for the debt on the property by the taxpayer, even if the taxpayer pledges to pay off the mortgage. Subsequent payments on the mortgage may be deductible as charitable contributions.

If the charity receives property that is subject to debt and uses the property solely for its charitable purposes, then the unrelated business income tax ("UBIT") rules discussed in Section H and Chapter 4 may not be a concern.

On the other hand, if the charity receives encumbered property and rents it for commercial purposes to generate income that is used for charitable purposes, the UBIT rules apply, even though rent received on a building by a charity is otherwise not subject to UBIT, as discussed in Chapter 4.

Fortunately, there are exceptions to the debt-financed UBIT rules that can cause the rules not to apply for the first ten years after acquisition by the charity if the donor (1) owned the property for more than five years before it was donated and (2) the mortgage debt was placed on the property more than five years before it was donated to the charity.

[57] *Id.* at 905-06.

Section H provides an overview of the UBIT rules and Chapter 4 explains exceptions to these rules.

3. Transferring a Building Separate from the Land Beneath It—Tangible Property Rules and Required Charitable Use

The transfer of a house or other building separate from the land that it occupies may qualify for a charitable deduction if the value of the house exceeds the value of the benefit that the taxpayers would receive from having the charitable organization demolish or move it.[58]

Section 170(f)(3)(A) provides the "partial interest rule":

> In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

In the 2021 opinion of *Mann v. United States*,[59] the U.S. Court of Appeals for the Fourth Circuit used the above rule to deny a charitable income tax deduction when the taxpayers did not separate a physical house from the land it was on at the time that they purported to transfer the house.

The taxpayers (a husband and wife) decided to tear down the existing house on their property and build a new one in its place. The couple claimed that they were donating the existing house in its entirety to a 501(c)(3) organization, but not the underlying land. The couple then took a charitable deduction of $675,000 on their income tax return, representing the appraised value of the house that would have applied if it was moved intact to another lot.

A house detached from real estate is tangible personal property. If the house is donated to a charity, the house must be used for the purposes of the charitable organization in order to be deductible at fair market value. The charitable organization in the *Mann* case satisfied this

[58] *Rolfs v. Comm'r*, 135 T.C. 471, 486-87 (2010).
[59] 984 F.3d 317 (4th Cir. 2021).

requirement by running a legitimate vocational training program that taught students how to dismantle houses.[60]

Another example was the donation to the Library of Congress of motion picture film stock, including the 1938 American drama "Algiers," Warner Brothers feature films and cartoons, and Popeye cartoons,[61] where the donor transferred only the physical film but retained all other rights related to the film's content.[62] The Library of Congress spent over $1 million to preserve the film, of which the donor contributed nothing. The United States Court of Appeals for the Federal Circuit held in its 1990 opinion *Transamerica Corp. v. United States* that this transfer did not qualify for a charitable deduction because the donor retained the rights that made the film valuable and benefitted from the preservation of the film.

One application of § 170(f)(3) was that an individual who bought or otherwise owned the painting but not the copyrights thereto would not be able to get a charitable deduction for donating the physical painting if he did not also transfer the copyright. Under U.S. law, the purchase of a painting does not include the copyright to the painting, which is retained by the artist unless otherwise specifically transferred. This tremendous trap for the unwary was cured by the enactment of Treasury Regulation Section 1.170A-7(a)(2)(i), which states that "a deduction is allowed without regard to this section for a contribution of a partial interest in property if such interest is the taxpayer's entire interest in the property, such as income interest or a remainder interest." Artwork copyright issues are further discussed in Chapter 3.

G. **Donating Assets Subject to Restricted Uses**

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[60] "Second Chance is a § 501(c)(3) charitable organization based in Baltimore, Maryland, that offers deconstruction services to further its mission of providing 'workforce development and job training opportunities to disadvantaged members of the community' who carry out the deconstruction, while also preventing 'salvageable building materials and fixtures from [ending up in] landfills.' The participants in the deconstruction program are employees who are paid an hourly wage and learn construction skills. Second Chance's deconstruction work involves the 'systemic dismantling of a structure' to remove some building components 'for preservation and salvage.' Other components, like drywall, tile, and roofing materials, are necessarily destroyed as part of the deconstruction process, and yet others are destroyed as part of the employees' training. . . . Second Chance emphasizes, however, that it does not 'provide demolition services,' and it advises deconstruction donors that they 'must engage a demolition contractor at their own expense.' The charity 'owns and operates a warehouse and retail store ... from which it resells furniture, fixtures, and building materials' that it has recovered through deconstruction or that people have otherwise donated." *Mann* at 320.

[61] Even Popeye and Bugs Bunny, working together as cartoon superheroes, could not overcome the severe restraints set forth under the Treasury Regulations. The IRS thought Olive Oil was slippery.

[62] *Transamerica Corp. v. U.S.*, 902 F.2d 1540 (Fed. Cir. 1990).

A donor may restrict future use of assets contributed to a charitable organization. However, the donor is not permitted to prevent the charity from effectively using the assets or income derived from them for the organization's exempt purposes.

For example, an individual may put deed restrictions in the public records to prevent a property that will be donated as a park from being used as anything but a park. An individual, however, cannot receive a deduction for donating property to a charity and requiring that the charity not use the property whatsoever, unless there are environmental purposes such as to preserve green space and animal habitats.

The donor is permitted to make the transfer of continued ownership contingent on a future act or event if "the possibility that the charitable transfer will not become effective is so remote as to be negligible."[63] An example of this is a donor's requirement that real estate contributed to a city be used as a park. Despite the donor's requirement, Treasury Regulation § 1.170A-1(e) permits a deduction "[i]f on the date of the gift the city does plan to use the land for a park and the possibility that the city will not use the land for a public park is so remote as to be negligible."

A problem will also arise where the donor retains a right to use the asset after the transfer. For example, if a donor gives property away to be designated as a public park but retains the right to use the park land exclusively on his birthday. The issue is whether the retained rights are substantial enough to affect the deductibility of the property contributed. In Rev. Rul. 75-66, 1975-1 C.B. 85, a donation of the taxpayer's entire interest in 800 acres of land to the United States was deductible under Section 170 despite his retention of a lifetime right to train his hunting dogs on the property. The reasoning was that his retained right was not substantial enough to deny a deduction.

H. Donations to Charitable Remainder Trusts

Unencumbered real estate can be donated to charitable remainder trusts. However, the rent income from the property may be insufficient for the trust to make its required annual payments.

Real estate will often be donated to a "Flip" Net Income with Make-Up Charitable Remainder Unitrust ("Flip-NIMCRUT") with payments deferred until the property is sold. The Flip-NIMCRUT is described in Chapter 3.

The sale of real estate can be identified under a Flip-NIMCRUT as a cause for the trust to "flip the switch" and begin paying the annual unitrust amount.

A transfer of encumbered property to a charitable remainder trust ("CRT") is considered a gift only to the extent of the excess of the fair market value of the property over the amount owed.

[63] Treas. Reg. § 1.170A-1(e) (as amended in 2020).

If handled properly, the donor who agrees to make all mortgage payments will receive a tax deduction for the initial contribution. The donor will also receive deductions for the mortgage payments in the amount of the value of the remainder interest under the trust at the time that each payment is made.

Transferring encumbered property to a CRT implicates the self-dealing rules, which may be avoided if the mortgage has been on the property for more than ten years before the gift is made or the mortgaged property was the sole initial asset transferred to the trust under Treasury Regulation § 53.4941(d)-1(a). These rules must be navigated very carefully.

The self-dealing rules, along with other potential traps for the unwary, are explained in Chapter 4. For purposes of this introduction, please note that a CRT is subject to a 100% excise tax on debt-financed income, unless an exception applies.

In addition to a CRT, real estate can also be donated to facilitate participation in pooled income funds and for charitable gift annuities. Real estate is also an appropriate gift to a charitable lead trust ("CLT") if the real estate generates sufficient rent income to allow the CLT to make its required annual charitable payments. The chart below compares the characteristics of charitable remainder trusts, charitable gift annuities, and pooled income funds.

Charitable lead annuity trusts can be "grantor trusts" like the individual grantor and thus not subject to UBTI rules for the lifetime of the grantor but will be subject to excess business holding rules and self-dealing rules.

A non-grantor CLAT cannot take a charitable deduction for the distribution of UBTI.[64]

[64] I.R.C. § 681.

Comparison of a Charitable Remainder Trust, Charitable Gift Annuity, and a Pooled Income Fund

	Can the Donor Donate Appreciated Assets and Get a Tax Deduction Against Ordinary Income?	**Control /Payments**	**Calculation of Payments**	**Notable Characteristics of Payments**	**Income Taxation of Payments Received**	**Death of Donor**
Charitable Remainder Trust	Yes. Funding a CRT with appreciated property will not result in a capital gain to the donor unless either the donor receives property in exchange (other than retention of an annuity or unitrust amount) or the property transferred to the trust has indebtedness in excess of its basis.	Donor Controlled – Pays stream of payments to donor Remainder to charity Term can be for up to 20 years and/or life of 1, 2, or 3 persons	Will vary depending upon design of trust CRAT- fixed annual payments CRUT- percentage of value annual payments	See Chapter 2. Worst comes out first	Income comes out "worse first" using tier system. After all taxable income is paid, tax-free income and principal come out income tax-free.	May end or continue depending upon terms

Charitable Gift Annuity	Yes. If the annuity is purchased with appreciated property, the donor's basis must be allocated between the gift portion and the bargain-sale portion.	Controlled by Charity – Annuitant(s) will receive a stream of payments based upon the type/version of the agreement. Charitable gift annuities are not issued for a fixed term of years, but it is possible to terminate the annuity payments in advance of the life-measuring term.	<u>Three Types of Agreements:</u> Can be immediate, deferred, or flexible annuity <u>Three "Versions" of Each Type of Agreement:</u> #1: A "single life" agreement (The annuity is paid to only one person for his/her lifetime.) #2: A "two lives in succession" agreement (The annuity is paid to A and then if B survives A, the annuity is paid to B.) #3: A "joint and survivor" agreement (The annuity is paid to two persons simultaneously. At the death of the first annuitant, the survivor is paid the full annuity amount.)	Dependent upon the charity not going bankrupt In bankruptcy, the donor is an unsecured creditor. Charitable gift annuities are backed only by the general assets of the charity, unless otherwise insured or guaranteed by an insurance company or by state law. Thus, payments are dependent upon the issuing charity being solvent and able to make the annuity payments.	Payments through life expectancy taxed as ordinary income and return of capital in uniform proportion. The non-deductible portion of the annuity is returned to the annuitant over his or her life expectancy. Once the non-deductible portion of the annuity is paid to the annuitant, the payments are then taxed as ordinary income.	Payments end after the death of the donor or after the death of the donor and another person.

Comparison of a Charitable Remainder Trust, Charitable Gift Annuity, and a Pooled Income Fund

	Can the Donor Donate Appreciated Assets and Get a Tax Deduction Against Ordinary Income?	**Control /Payments**	**Calculation of Payments**	**Notable Characteristics of Payments**	**Income Taxation of Payments Received**	**Death of Donor**
Pooled Income Fund	Yes. The donor realizes no taxable gain (or loss) as a result of making a gift to a pooled income fund if the transferred property is not subject to an indebtedness.	Controlled by Charity – Donor receives a stream of payments. A pooled income fund may not have an income interest measured by a term of years. The term of the income interest must be measured by the life of each individual beneficiary.	Payments vary in amount based on the performance of the fund for each taxable year. The amount received by the donor or other income beneficiary is proportional to the donor's share of the fund. The donor must retain an income interest for his or her life or create a life income interest in one or more beneficiaries living at the date of the transfer.	Insulated from the debts of the charity	Payments taxed as ordinary income.	Remaining funds go to charity upon the death of the last income beneficiary. Donor may reserve the testamentary right to terminate or revoke the income interest of any designated beneficiary other than that of the charitable remainder beneficiary.

I. A Brief Overview of Unrelated Business Taxable Income and Primary Exclusions

The rules and regulations regarding Unrelated Business Taxable Income ("UBTI") are complex and apply to nearly all tax-exempt organizations.

UBTI is discussed throughout this book, so we hope that this section, as well as Chapter 4, assists the reader in becoming familiar with this subject and its applications.

1. <u>"Unrelated Business Taxable Income" (UBTI) Defined</u>

IRC § 512(a)(1) defines the term "unrelated business taxable income" as "the gross income derived by any organization from any unrelated trade or business . . . regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business."

When determining whether a tax-exempt organization's income is subject to the UBTI tax, the following analysis normally applies:

- Is there income derived from any of the following?
  - Is there income derived from a trade or business?
  - Is there income from assets that are subject to indebtedness (debt financed assets)?
  - Is there K-1 income from an entity taxed as an S corporation?
  - Is there income by K-1 reporting from an entity taxed as a partnership?
- If there is income derived from a trade or business, is the trade or business regularly carried on (more than once a year normally applies)?
- If there is income derived from a trade or business that is regularly carried on, is the trade or business substantially related to the tax-exempt purposes of the 501(c)(3) organization?
- Does the trade or business qualify for a statutory-exemption or modification?

2. <u>"Trade or Business" Defined</u>

Treasury Regulation § 1.513-1(b) defines trade or business under the UBTI rules as "generally includ[ing] any activity carried on for the production of income from the sale of goods or performance of services."

3. <u>"Regularly Carried On" Defined</u>

The business activities of a tax-exempt organization are deemed to be regularly carried on if they "manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations."[65]

Treasury Regulation § 1.513-1(c)(2)(ii) provides that "[i]n determining whether intermittently conducted activities are regularly carried on, the manner of conduct of the activities must be compared with the manner in which commercial activities are normally pursued by non-exempt organizations."

4. "Substantially Related" Defined

Perhaps because it is easier to determine what is not substantially related than what is, IRS Publication 598 (March 22, 2021) summarizes the characteristics of a business activity that is *not* substantially related:

> A business activity isn't substantially related to an organization's exempt purpose if it doesn't contribute importantly to accomplishing that purpose (other than through the production of funds). Whether an activity contributes importantly depends in each case on the facts involved.
>
> In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function that they intend to serve. For example, to the extent an activity is conducted on a scale larger than is reasonably necessary to perform an exempt purpose, it doesn't contribute importantly to the accomplishment of the exempt purpose. The part of the activity that is more than needed to accomplish the exempt purpose is an unrelated trade or business.

This is a summary of the definition of substantially related provided in Treasury Regulation § 1.513-1(d), which reads as follows:

> Gross income derives from unrelated trade or business, within the meaning of section 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates

[65] Treas. Reg. § 1.513-1(c)(1) (as amended in 2020).

> an examination of the relationship between the business activities which generate the particular income in question - the activities, that is, of producing or distributing the goods or performing the services involved - and the accomplishment of the organization's exempt purposes.

Chapter 4 continues this explanation of UBTI, in addition to discussing other important rules and limitations that apply to charitable organizations, including the Self-Dealing Rules and the Excess Business Holding Rules.

J. Client Letters that Describe General and Specific Planning Situations

This section provides the below sterilized letters which readers may wish to peruse and use in understanding commonly communicated planning opportunities and client communication purposes.

September 5, 2023
VIA EMAIL TRANSMISSION ONLY
mailto:client@insurance.com
Dear Client:

I am enclosing a draft Form 1023 Application for the NoName Scholarship and Award Charitable Trust in order to apply for tax-exempt status for the Foundation.

Please note that the Form 1023 is due 27 months after the entity has been formed, although this can be extended if the organization can show good cause.

Nevertheless, it is better to file the Form 1023 sooner rather than later so that you can inform donors that tax exempt status has been formally awarded, and be able to show the completed Application to any donors or organizations that may request it.

The IRS does not expect perfection with respect to estimates and predictions of contributions
and expenditures as long as they are provided in good faith.

Please note that there are two basic categories of private foundations: private foundations and private operating foundations.

Private operating foundations are better treated under the tax rules because appreciated assets other than just securities can be contributed to receive an income tax reduction.

A private operating foundation must be an active operational entity, as described in the attached literature.

You will probably want to qualify as a private operating foundation or as a public charity (as described below) in case people want to donate horses and horse related equipment, or possibly even appreciated pasture or other real estate to get an income tax deduction.

A step above the private operating foundation would be a "public charity" which would need to receive more than one-third of its support from donors who contribute less than 2% of the total receipts received by the foundation. This "one-third test" is over simplified above, but better described by the attached literature.

I believe that you would have a good chance of qualifying as a public charity, assuming that the Go Fund Me contributors are each considered to be a separate contributor and that the one-third test is met.

The public charity designation is not based upon the exact circumstances that exist at the time of the filing of the Form 1023.

It is instead based upon the expected donations, which can include expected public grants and donations from other charities.

If you believe that your personal contributions would be more than two-thirds of total revenues, then you might personally contribute to another charity, such as the Marion County Community Foundation, and ask that they put the money to good use in a parallel but separate manner. I am not sure how aggressive of an approach this is, but can ask a subspecialist lawyer if you like.

The advantages of public charity status are as follows:

1. Individuals can transfer money to a public charity from their personal donor advised funds.

2. A good many grants that are provided by public and private charities and employer charitable matches are conditioned upon the entity qualifying as a public charity.

3. The donors and managers of a public charity can enter into arm's length transactions with the public charity.

You should know that even if the entity is classified as a private foundation, you can loan money to it at a zero percent interest rate and you can provide it with free rent, and also receive reasonable compensation for many types of services that you can personally provide. These are generally "white collar management services" as opposed to "blue collar labor."

If you go for public charity status the IRS will likely require a board of Trustees that has a majority of members other than the two of you and members of your family, but we can start with the two of you as Trustees and see if this is approved.

If the IRS does require an independent board, then you can have the ability to select and replace the unrelated board members as part of the arrangement.

Many clients evaluate what the minimum amount that they plan to give and leave to charity during their lifetimes and at death, and then transfer that amount to a private foundation or public charity to get a tax deduction now for what they know that they will donate eventually.

Typically, they give up to 50% of their adjusted gross income each year, or up to 30% of adjusted gross income in appreciated assets each year, to get income tax savings now for charitable contributions or work that can be made later.

CHAPTER 2:
CHARITABLE ORGANIZATIONS

While there are many different types of charitable organizations that can be used by a business or investment donor, the primary ones used for the purposes described in this book are discussed below. Donors may receive income tax deductions for making donations to 501(c)(3) organizations, although the nature and extent of the deduction will depend on what kind of 501(c)(3) organization is used.

All 501(c)(3) organizations are either Private Foundations or Public Charities. This is most often determined by the extent of public involvement in the organization's activities.[66]

An example of an advantageous arrangement is a Charitable Lead Annuity Trust that receives a contribution of assets valued at $1 million which provides the grantor with income tax savings of $370,000 at the 37% income tax bracket in the year of funding. Significant amounts may pass estate-tax-free to the grantor's descendants after the trust has made annual payments for a term of years to a Private Operating Foundation that employs the grantor's children and pays them reasonable compensation for appropriate charitable work. A $370,000 income tax reduction, coupled with moving significant assets to descendants without payment of estate and gift tax and permitting the descendants to operate and be compensated by a charitable foundation can certainly exceed the benefit of simply giving the $1 million to descendants and paying a 40% estate tax, assuming that the donor has used all of his or her estate and gift tax exemption.

As a specific example, as of January 2024 when the I.R.C. §7520 rate is 4.2% an individual can fund a 15 year CLAT that will pay__% of its day one value to charity each year for 15 years, and thereafter be held for or distributed to descendants of the grantor without being considered to be a gift to them.

Assuming that the CLAT assets have a 7% per year rate of return the amount remaining in the trust for the children after 15 years will be __% of the original contribution amount. This is further discussed below.

Donors have several planning options to consider, which will be explored in this section: Public Charities, family-controlled Public Charities, Private Operating Foundations, charitable remainder trusts, private non-operating foundations, and single-parent title-holding companies. The Treasury Department published the following chart that provides an overview of the "Universe of Section 501(c)(3) Organizations."[67]

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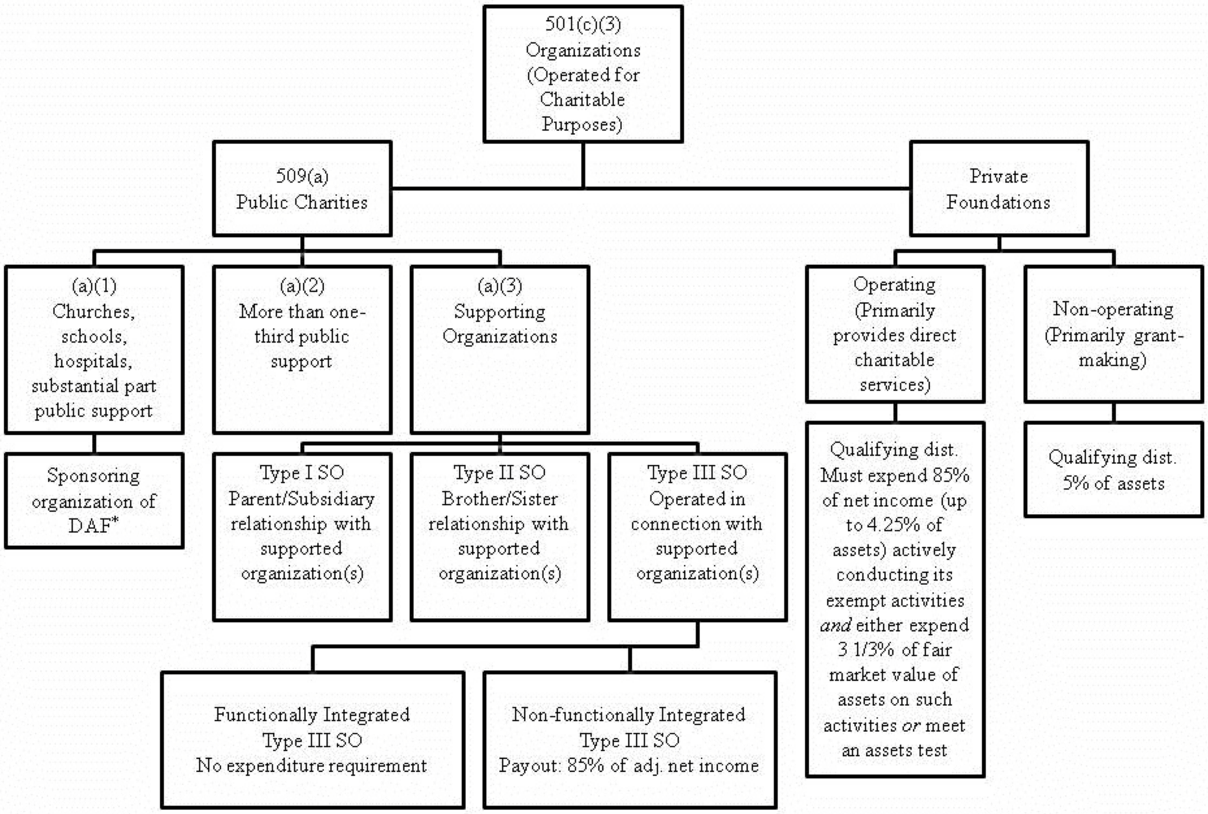
[66] *EO Operational Requirements: Private Foundations and Public Charities*, I.R.S., https://www.irs.gov/charities-non-profits/eo-operational-requirements-private-foundations-and-public-charities (last visited June 21, 2022).
[67] *Report to Congress on Supporting Organizations and Donor Advised Funds*, Department of the Treasury, 10 (Dec. 2011), https://home.treasury.gov/system/files/131/Report-Donor-Advised-Funds-2011.pdf.



*Subject to certain restrictions, most organizations described in section 509(a) of the Code may be a DAF sponsoring organization, although most sponsoring organizations are described by section 509(a)(1) of the Code.

The following table prepared by the Treasury Department provides a summary of the major distinctions between Private Foundations, Public Charities, Supporting Organizations, and Donor Advised Fund Sponsoring Organizations:[68]

	Contribution Deduction Limitation for Individuals[69]	**Donor Control**	**Annual Distribution Requirements**	**Excise Taxes on Organization and/or Managers**
Operating Private Foundation	Cash: 50% of AGI Capital Gain Property: 30% of AGI	Donor may control the organization.	Must expend 85% of net income (up to 4.25% of assets) actively conducting its exempt activities *and* either expend 3 1/3% of fair market value of assets on such activities *or* meet an assets test.	On acts of self-dealing with disqualified persons, investment income, excess business holdings, jeopardizing investments, taxable expenditures, and political expenditures.
Non-Operating Private Foundation	Cash: 30% of AGI Capital Gain Property: 20% of AGI	Donor may control the organization.	Must expend 5% of fair market value of assets not devoted to charitable use. Grants made to non-functionally integrated Type III SOs and certain other SOs are not qualifying distributions.	On acts of self-dealing with disqualified persons, investment income, failure to meet the mandatory distribution requirement, excess business holdings, jeopardizing investments, taxable expenditures, and political expenditures.

[68] [68] *Report to Congress on Supporting Organizations and Donor Advised Funds*, Department of the Treasury, 16-19 (Dec. 2011), https://home.treasury.gov/system/files/131/Report-Donor-Advised-Funds-2011.pdf.

[69] Corporations may also receive a charitable contribution deduction. The rules are set forth in Section 170 (b)(2) charitable contribution limit of 10% of taxable income. In addition to the overall limitation on total charitable contribution deductions, Section 170 of the Code sets forth rules for determining the amount that may be deducted for contributions of certain types of property. These rules distinguish between types of donors (individuals or corporations), types of donees (public charities or private foundations), types of property contributed (e.g., cash, capital gain property, ordinary income property, and inventory), and in some cases, distinguish between whether or not the contributed property is used to directly further the exempt purpose of the organization.

	Contribution Deduction Limitation for Individuals[69]	**Donor Control**	**Annual Distribution Requirements**	**Excise Taxes on Organization and/or Managers**
Public Charity 509(a)(1) 509(a)(2) (not a Donor Advised Fund Sponsoring Organization)	Cash: 50% of AGI Capital Gain Property: 30% of AGI	Donors may, but generally do not, control the organization. Donors may offer non-binding advice on investment and distribution of assets.	Medical research organizations must expend at least 3.5% of fair market value of assets for or devote more than 50% of assets to the active conduct of medical research.	On excess benefit transactions, excessive lobbying, and political expenditures.
Donor Advised Fund and Sponsoring Organization	Cash: 50% of AGI Capital Gain Property: 30% of AGI Deduction not allowed for contributions to DAFs whose sponsoring organizations are war veterans organizations, fraternal lodges, cemetery corporations, or non-functionally integrated Type III SOs.	Donors may, but generally do not, control the organization. Sponsoring organization owns assets and returns on assets. Donor may offer non-binding investment and distribution advice.	None.	On excess benefit transactions, excessive lobbying, political expenditures, and excess business holdings in DAFs. On distributions from DAFs to individuals, or to certain organizations unless made for a charitable purpose and expenditure responsibility is exercised. On distributions from DAFs that convey a more-than-incidental benefit to a donor, advisor, family member, or controlled entity.
Type I Supporting Organization	Cash: 50% of AGI Capital Gain Property: 30% of AGI	Donor may not control SO. SO is controlled by its supported organization.	None.	On excess benefit transactions, excessive lobbying, and political expenditures.

	Contribution Deduction Limitation for Individuals[69]	**Donor Control**	**Annual Distribution Requirements**	**Excise Taxes on Organization and/or Managers**
Type II Supporting Organization	Cash: 50% of AGI Capital Gain Property: 30% of AGI	Donor may not control SO. SO is controlled by persons who control its supported organization.	None.	On excess benefit transactions, excessive lobbying, political expenditures, and excess business holdings if the SO accepts a contribution from a donor who controls a supported organization.
Functionally Integrated Type III Supporting Organization	Cash: 50% of AGI Capital Gain Property: 30% of AGI	Donor may not control SO. SO is NOT controlled by its supported organization.	None.	On excess benefit transactions, excessive lobbying, and political expenditures.
Non-Functionally Integrated Type III Supporting Organization	Cash: 50% of AGI Capital Gain Property: 30% of AGI	Donor may not control SO. SO is NOT controlled by its supported organization.	Must distribute [the greater of] 85% of net income [or its minimum asset amount "reduced by the amount of taxes imposed on the supporting organization under subtitle A of the Internal Revenue Code during the immediately preceding taxable year."[70]]	On excess benefit transactions, excessive lobbying, political expenditures, and excess business holdings.

[70] Treas. Reg. § 1.509(a)-4(i)(5)(ii)(B) (as amended in 2015).

A. Requirements to Qualify as a 501(c)(3) Charitable Organization

Before examining the various types of charitable entities, it is important to understand the requirements necessary to qualify as a 501(c)(3) charitable organization. These include satisfying the Organizational Test, the Operational Test, and the requirement that private benefits must be incidental.

1. The Organizational Test

The Organizational Test applies to all 501(c)(3) organizations, including Public Charities, Private Foundations, and Private Operating Foundations. IRC § 501(c)(3) provides that qualifying charitable organizations must be "organized and operated" for charitable purposes. The Regulations provide "Organizational and Operational Tests" that are used to determine whether a charitable organization is "organized and operated" for charitable purposes.

The Organizational Test requires the following:

(1) The organization must be exclusively organized for one or more permissible exempt purposes, which are included in its articles of organization;

(2) The organization does not have the power to engage in legislative or political activities; and

(3) Upon dissolution, the assets of the organization must be distributed to advance its charitable purpose (as outlined in its articles of organization).[71]

The IRS notes the following regarding the Organizational Test:

> Generally, an organization is organized exclusively for one or more exempt purposes only if its organizational documents:
>
> - Limit the purposes of such organization to one or more exempt purposes,
> - Do not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes,
> - Do not expressly empower it to:

[71] Treas. Reg. § 1.501(c)(3)-1(b) (as amended in 2017).

- devote more than an insubstantial amount of its activities to attempting to influence legislation;

- participate or intervene in any political campaign on behalf of or in opposition to any candidate for public office; and

- engage in activities which characterize it as an "action" organization,[72]

- The organizational documents must also permanently dedicate the organization's assets to charitable purposes upon dissolution.[73]

2. The Operational Test

The Operational Test must also be met by all 501(c)(3) organizations to ensure that the organization is operating for the exempt purpose for which it is designated. The organization's activities cannot include influence and/or involvement in legislative or political action, and private shareholders or individuals cannot materially benefit from the actions of the organization.[74] Making a contribution to any political campaign is prohibited, and a charitable organization must not engage in "substantial" political lobbying.

The IRS notes the following about the Operational Test:

> The operational test for exemption under Section 501(c)(3) consists of four broad categories:
>
> 1. Requirement to operate exclusively for exempt purposes
>
> 2. Prohibition against private inurement
>
> 3. Prohibition against becoming an action organization; and

[72] Treas. Reg. § 1.501(c)(3)-1(c)(3) defines an "action organization" as any one of the following: (1) an organization in which a substantial part of its activities is attempting to influence legislation by propaganda or otherwise, (2) an organization which participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office, or (3) an organization which has the following two characteristics: (a) its main or primary objective or objectives may be attained only by legislation or a defeat of proposed legislation; and (b) it advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public.

[73] *Charitable Hospitals - General Requirements for Tax-Exemption Under Section 501(c)(3)*, I.R.S. (Aug. 3, 2021), https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3.

[74] Treas. Reg. § 1.501(c)(3)-1(c) (as amended in 2017).

4. Prohibition against substantial private benefit[75]

Please note that 501(c)(4) social welfare organizations can benefit political causes, including political action committees ("PACs") and can have the benefit of tax-free income. However, donations to a § 501(c)(4) social welfare organization are not tax-deductible, and they are also not considered to be gifts for federal gift tax purposes.

3. <u>Private Benefits Must be Incidental</u>

The net earnings from 501(c)(3) organizations cannot be used for the private benefit of any individual. Incidental benefits which are a mere byproduct of the public benefit are permitted, but non-incidental private benefits are prohibited. Stated another way, any private benefit from the organization's activities must be incidental in relation to the community benefit conferred by such activities. Whether an organization's activities will serve private interests excessively is a factual determination.

The Tax Court provided a useful definition of private benefit in *American Campaign Academy v. Commissioner*: "non-incidental benefits conferred on disinterested persons [that] serve private interests."[76]

General Counsel Memorandum 37789 helps define what will qualify as incidental by explaining that the private benefit must be both qualitatively and quantitatively incidental.

Qualitatively incidental means that the private benefit is a mere byproduct of the public benefit. A good example is Rev. Rul. 70-186, in which an organization was formed to preserve and enhance a large lake bordering several municipalities as a public recreational facility by treating the water. The public used the lake extensively for recreation. The organization was financed by contributions from property owners, members of the adjacent communities, and municipalities bordering the lake. The Revenue Ruling concluded that the benefits from the organization's activities flow principally to the general public through well maintained and improved public recreation facilities. Any private benefits derived by the lake-front-property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake-front-property owners.

For the private benefit to be quantitatively incidental, it must be insubstantial in amount. The private benefit must be compared to the public benefit of the specific activity in question, not the public benefit provided by all of the organization's activities. The more precisely you can quantify the private benefit, the more likely it is to be non-incidental. One should also consider the number of entities benefitting. That is, if all of an organization's business dealings are with a single entity (or group of related entities), promoter, or developer, private benefit is more likely to

[75] *Charitable Hospitals - General Requirements for Tax-Exemption Under Section 501(c)(3)*, I.R.S. (Aug. 3, 2021), https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3.
[76] *Am. Campaign Acad. v. Commissioner*, 92 T.C. 1053, 1069 (1989).

be present. Further, private benefit is more likely to be substantial if the group receiving the benefit is small.

Receipt of a private benefit is prohibited and can lead to sanctions against the insider and the organization as a whole. Insiders include those who are able to exercise substantial influence over the organization and can sometimes be physicians in addition to administrators depending on the physician's supervisory responsibility within the organization.

Revenue Rulings have permitted a charitable hospital to retain profits. However, those profits must be used to provide care to underserved groups or for the benefit of the hospital in furthering its charitable purpose, such as upgrading equipment to expedite services, purchasing new technology to provide expanded care to the public, or adding to its endowment.

Many of the actions and activities that are typical in for-profit entities should be conducted only at "arm's-length" in charitable hospitals. They must also be consistent with the written policies and purposes of the organization to avoid jeopardizing the tax-exempt status of the charitable hospital. These practices include not only recruitment but also employee compensation and benefits, leasing of office space, and purchases of physician practices.

Joint ventures between for-profit organizations and a 501(c)(3) hospital/clinic organization are permitted so long as there are not factors present that would threaten the exempt status. A diligent charitable hospital needs to maintain the operation of the joint venture in a manner sufficient to achieve its exempt charitable purpose. Should the activity within the joint venture not further the hospital's charitable purposes, there may be assessment of unrelated business income taxation under I.R.C. 512(c).

B. Public Charities

Varieties of Public Charities		
Common Name for Organization	How to Qualify	Prominent Limitations of Organization
Public Charity: Broadly Supported	Received significant support from small donors – 33% from small (under 2%) donors, or 66% from donors and fundraising	No prominent limitations
Public Charity: Operate a School, "Hospital," or Church	Must operate a physical school, medical facility, research organization, or church	IRS may require primary or sole donor to not control the board upon formation.
Community, Faith-Based, or Common Interest Foundation	Will normally qualify as a public charity	No prominent limitations
Donor Advised Fund	Will normally qualify as a public charity	IRS strongly discourages contributions for events where the DAF pays the charitable portion and the donor pays the non-charitable portion, i.e., a benefit gala at $1,000 a person – deductible for $700 per person.
Type I Supporting Organization	Operated, supervised, or controlled by the public charities they support	Must be organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more public charities.
Type II Supporting Organization	Supervised or controlled in connection with the public charities they support	Must be organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more public charities.

Varieties of Public Charities		
Common Name for Organization	How to Qualify	Prominent Limitations of Organization
Type III Supporting Organization	Operated in connection with the public charities they support.	Must meet a "responsiveness test" (the organization is required to "be responsive to the needs or demands of the publicly supported organization") and an "integral part test" (the organization is required to "maintain significant involvement in the operations of" at least one publicly supported organization and the publicly supported organizations are required to be "dependent upon the supporting organization for the type of support which it provides.") The "integral part test" is used to determine whether a Type III supporting organization is "functionally integrated" or "non-functionally integrated."

The best results for many large donations will typically be realized by contributing to a type of 501(c)(3) organization known as a Public Charity. Types of Public Charities include donor-advised funds, community foundations, and certain family-controlled Public Charities.

One way to form a Public Charity is to convert a Private Operating Foundation to public-charity status. For a Public Charity to be approved under a Form 1023 Application for Tax Exempt Status (attached as Exhibit B-Application for Recognition of Exemption), the IRS commonly requires that the primary donor(s) cannot control the organization. However, Private Foundations and Private Operating Foundations do not face the same restriction. For this reason, the IRS may not require the same lack-of-control when a Private Foundation or Private Operating Foundation converts to public-charity status. This could result in a Public Charity controlled by the primary donor(s).

Public Charities enjoy several benefits not available to Private Operating Foundations, including no minimum annual payment or expenditure requirements, no strict prohibitions on arm's-length transactions and contractual relationships with donors and affiliates, and no 1.39% annual tax on foundation income.

The section below entitled *Verifying Tax-Exempt Status and Public Charity Qualification* provides instructions for verifying that an existing entity is qualified as a Public Charity by the IRS.

Many advisors are not aware that donor-controlled Public Charities may be relatively easy to form and operate by arranging the charity as a school, medical facility (meeting the loose definition of "hospital"), church, medical research organization, or "publicly supported" arrangement. The following entities can qualify as Public Charities even if all donations come from one individual or a handful of individuals or companies:

1. <u>Schools operated from physical facilities that have faculties (teachers) and curriculum (classes on specific subjects) and can also have online classes or other activities</u>

The IRS defines the term educational broadly, permitting an organization to advance a particular point-of-view if it does so fairly:

> The term educational, as used in section 501(c)(3), relates to:
> (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
> (b) The instruction of the public on subjects useful to the individual and beneficial to the community.
>
> An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion.[77]

In addition to traditional schools and colleges, the Treasury Department lists a variety of less-conventional organizations that meet its definition of an educational organization, including zoos, symphony orchestras, and public discussion groups.[78] Notice as well that the definition does not limit the educational organization to in-person activities. Educational online, radio, and television activities can qualify an organization as educational.

2. <u>Churches, Synagogues, Mosques, Other Houses of Worship, and Conventions or Associations of Such Entities</u>

IRC § 170(c) defines Charitable Contributions as a contribution or gift to or for the use of

[77] Treas. Reg. § 1.501(c)(3)-1(d)(3).
[78] Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii).

> (2) A Corporation, trust, or community chest, fund, or foundation – . . . (B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes. . . .

This means contributions and gifts made to trusts, funds, or foundations may qualify for the deduction if the entity is organized and operated exclusively for supporting religious or charitable purposes, such as supporting a church or other religious organization. Entities, therefore, supporting churches may qualify.

IRC § 170(b)(1)(A)(i) includes "a church or a convention or association of churches" in its list of institutions that are per se public charities, assuming that they otherwise meet the qualifications for 501(c)(3) status.[79]

a. Defining "Church"

Neither the Code nor the Regulations provide a definition of "church". Not all religious entities qualify as churches within the meaning of § 170. Proposed regulations have introduced definitions of the term. The proposed definition was removed when the final regulations were published.[80] The Supreme Court has also never defined these terms for purposes of the Internal Revenue Code.

Although the term "church" is historically associated with Christianity, for purposes of the Internal Revenue Code, the term incorporates a 501(c)(3) organization that is organized and operated for "religious purposes", with respect to any religion. Defining "religion" and "religious purposes" is therefore also of issue. The Supreme Court has not defined "religion" for purposes of the Internal Revenue Code and has been careful when defining it in other contexts, and has tended to examine the sincerity of religious belief rather than the doctrine espoused by the religion.

The IRS published a Technical Advice Memorandum[81] in 1995 that included the following 14 factors, based upon case law, that it considers to be helpful when determining whether a religious organization is a church:

1) A distinct legal existence;
2) A recognized creed and form of worship;
3) A definite and distinct ecclesiastical government;
4) A formal code of doctrine and discipline;
5) A distinct religious history;
6) Membership not associated with any other church or denomination;
7) Ordained ministers;
8) Selection of ministers for ordination after prescribed studies;
9) Its own literature;
10) Established places of worship;

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[79] I.R.C. § 501(c)(3) ("organized and operated exclusively for religious [purposes], . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation").
[80] See for example Former Prop. Reg. §1.170(a)-9(a).
[81] I.R.S. Tech. Adv. Mem. 9624001 (Nov. 13, 1995).

11) Regular congregations;
12) Regular religious services;
13) "Sunday School" for instructing children; and
14) Schools for preparing clergy.

The Tax Court has not adopted the 14 factors above as a formal test but has used the factors in its analysis when determining whether a religious organization qualifies as a church.[82]

The Tax Court has also helped to define "church." In its 1987 opinion, *Foundation of Human Understanding v. Commissioner*,[83] the Tax Court provided the following discussion of the term:

> Although every church may be a religious organization, not every religious organization is a church. To classify a religious organization as a church under the Internal Revenue Code, we should look to its religious purposes and, particularly, the means by which its religious purposes are accomplished. "The means by which an avowedly religious purpose is accomplished separates a 'church' from other forms of religious enterprise. * * * At a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship." When bringing people together for worship is only an incidental part of the activities of a religious organization, those limited activities are insufficient to label the entire organization a church.[84]

b. Defining "Convention or Association" of Churches

Determining whether a 501(c)(3) organization qualifies as a convention or association of churches also requires a review of the case law because the Code does not define "convention or association" for purposes of this Section. The only additional guidance provided by the Code is Section 7701(n), which provides that "any organization which is otherwise a convention or association of churches shall not fail to so qualify merely because the membership of such organization includes individuals as well as churches or because individuals have voting rights in such organization."

The legislative history of Congress's use of the phrase indicates that it was added at the urging of Baptist leaders who were concerned that by not distinguishing between "churches" and "conventions or associations" of churches, the statute would be unclear regarding whether independent congregational churches would qualify as "churches."[85] By distinguishing "churches" from "conventions or associations" of churches, Congress made clear that the term included both hierarchical church denominations as well as independent congregational churches.

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[82] *VIA v. Commissioner*, 68 T.C.M. (CCH) 212 (1994); *Foundation of Human Understanding v. United States*, 88 Fed. Cl. 203 (2009), *aff'd*, 614 F.3d 1383 (Fed. Cir. 2010), *cert. denied*, 131 S. Ct. 1676 (2011).
[83] 88 T.C. 1341 (1987).
[84] Internal citations omitted.
[85] *Lutheran Soc. Serv. of Minn. v. United States*, 758 F.2d 1283, 1288 (8th Cir. 1985).

Revenue Ruling 74-224, 1974-1 C.B. 61, addressed whether a convention or association of churches can be made up of churches from multiple denominations. While acknowledging that the term "has a historical meaning generally referring to a cooperative undertaking by churches of the same denomination," the IRS concluded that "nothing in the legislative or religious history of the term prevents its application to a cooperative undertaking by churches of differing denominations . . . . The term is not limited in its application to a group of churches of the same denomination."

c. Integrated Auxiliaries of Churches

Although IRC § 170 does not use the term "integrated auxiliary of a church," IRC § 6033 provides that "integrated auxiliaries of a church" can be eligible to be treated as a 501(c)(3) organization and be exempt from filing Form 990, *Return of Organization Exempt From Income Tax* (see section on tax benefits below). Treasury Regulation § 1.6033-2(h) defines "integrated auxiliary of a church" as an organization that meets the following requirements:

> 2(h)(1)(i)—Described both in sections 501(c)(3) and 509(a)(1), (2), or (3);
>
> 2(h)(1)(ii)— Affiliated with a church or a convention or association of churches; and
>
> 2(h)(1)(iii)— Internally supported.
>
> 2(h)(2) An organization is affiliated with a church or a convention or association of churches . . . if--
>
>> 2(h)(2)(i)— The organization is covered by a group exemption letter issued under applicable administrative procedures . . . to a church or a convention or association of churches;
>>
>> 2(h)(2)(ii)— The organization is operated, supervised, or controlled by or in connection with . . . a church or a convention or association of churches; or
>>
>> 2(h)(2)(iii)— Relevant facts and circumstances show that it is so affiliated. . . .
>
> 2(h)(4) An organization is internally supported . . . unless it both-
>
>> 2(h)(4)(i)— Offers admissions, goods, services or facilities for sale, other than on an incidental basis, to the general public (except goods, services, or facilities sold at a nominal charge or for an insubstantial portion of the cost); and
>>
>> 2(h)(4)(ii)— Normally receives more than 50 percent of its support from a combination of governmental sources, public

> solicitation of contributions, and receipts from the sale of admissions, goods, performance of services, or furnishing of facilities in activities that are not unrelated trades or businesses.

The Regulation lists "[m]en's and women's organizations, seminaries, mission societies, and youth groups" as organizations that can meet its definition of "integrated auxiliary of a church." It is often more convenient to conduct foreign missionary activities as an integrated auxiliary of a church than as a separate 501(c)(3) organization because integrated auxiliaries are exempt from several filing requirements, as discussed in Section "d" below.

d. Tax Benefits of Churches and Conventions or Associations of Churches

In addition to the tax benefits provided to all public charities, the Internal Revenue Code provides additional benefits and protections to churches, conventions or associations of churches, and integrated auxiliaries of churches.

IRC § 508 exempts churches, conventions and associations of churches, and integrated auxiliaries of churches from the requirement of filing Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, with the IRS in order to qualify for tax-exempt status. Churches also are not required to file Form 990, *Return of Organization Exempt From Income Tax*, with the IRS.[86] An exception to this general rule is that churches must file a Form 990 if they have unrelated business taxable income.[87] IRC § 6043(b) exempts churches, their integrated auxiliaries, and conventions or associations of churches from filing returns related to "liquidation, dissolution, termination, or substantial contraction."

IRC § 7611 imposes a number of restrictions upon the IRS when conducting inquiries into and examinations of a church. Included among the restrictions are a requirement that the IRS can only conduct an inquiry into a church "if an appropriate high-level Treasury official reasonably believes (on the basis of facts and circumstances recorded in writing) that the church may not be exempt, . . . or may be carrying on an unrelated trade or business . . . or otherwise engaged in activities subject to taxation." The Section also provides a written notice requirement that requires the IRS to disclose the concerns that have given rise to the inquiry and its general subject matter at least 15 days prior to the beginning of the examination. The examination of the church is also strictly limited to records and activities related to the church's tax liability and inquiry into whether the church qualified as a church.

3. <u>Medical Research Organizations.</u>

Medical research organizations are described in IRC § 170(b)(1)(A)(iii) as being "directly engaged in the continuous active conduct of medical research in conjunction with a hospital" and not otherwise treated as a hospital.

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[86] I.R.C. § 6033.
[87] I.R.C. § 511.

An organization will not qualify as a medical research organization if it is inactive, or if it is an "organization primarily engaged in funding the programs of other medical research organizations."[88]

An organization will qualify as a medical research organization "primarily engaged directly in the continuous active conduct of medical research" if it satisfies one of the following two tests provided in Treas. Reg. § 1.170A-9(d)(2)(v): Test 1: "the organization must either devote a substantial part of its assets to, or expend a significant percentage of its endowment for, [medical research] purposes, or both." An organization satisfies this test if it either:

- "[D]evotes more than one half of its assets to the continuous active conduct of medical research";[89] or

- "[E]xpends funds equaling 3.5 percent or more of the fair market value of its endowment for the continuous active conduct of medical research."[90]

Test 2, alternatively, if Test 1 has not been met then the organization may satisfy a facts and circumstances test, based upon the following:

> [T]he factor given most weight is the margin by which the organization failed to meet such tests. Some of the other facts and circumstances to be considered in making such a determination are—
>
> (1) If the organization fails to satisfy the tests because it failed to properly value its assets or endowment, then upon determination of the improper valuation it devotes additional assets to, or makes additional expenditures for, such purposes, so that it satisfies such tests on an aggregate basis for the prior year in addition to such tests for the current year;
>
> (2) The organization acquires new assets or has a significant increase in the value of its securities after it had developed a budget in a prior year based on the assets then owned and the then current values;
>
> (3) The organization fails to make expenditures in any given year because of the interrelated aspects of its budget and long-term planning requirements, for example, where an organization

[88] Treas. Reg. § 1.170A-9(d)(2)(i) (as amended in 2020); Treas. Reg. § 1.170A-9(d)(2)(v)(C) provides that, "Engaging directly in the continuous active conduct of medical research does not include the disbursing of funds to other organizations for the conduct of research by them or the extending of grants or scholarships to others. Therefore, if an organization's primary purpose is to disburse funds to other organizations for the conduct of research by them or to extend grants or scholarships to others, it is not primarily engaged directly in the continuous active conduct of medical research."
[89] Treas. Reg. § 1.170A-9(d)(2)(v)(B) (as amended in 2020).
[90] *Id.*

> prematurely terminates an unsuccessful program and because of long-term planning requirements it will not be able to establish a fully operational replacement program immediately; and
>
> (4) The organization has as its objective to spend less than a significant percentage in a particular year but make up the difference in the subsequent few years, or to budget a greater percentage in an earlier year and a lower percentage in a later year.[91]

Finally, with respect to the requirement that medical research must be conducted in conjunction with a hospital to qualify as a medical research organization, Treas. Reg. § 1.170A-9(d)(2)(vii) provides the following:

> Medical research in conjunction with a hospital.
>
> The organization need not be formally affiliated with a hospital to be considered primarily engaged directly in the continuous active conduct of medical research in conjunction with a hospital, but in any event there must be a joint effort on the part of the research organization and the hospital pursuant to an understanding that the two organizations will maintain continuing close cooperation in the active conduct of medical research.
>
> For example, the necessary joint effort will normally be found to exist if the activities of the medical research organization are carried on in space located within or adjacent to a hospital, the organization is permitted to utilize the facilities (including equipment, case studies, etc.) of the hospital on a continuing basis directly in the active conduct of medical research, and there is substantial evidence of the close cooperation of the members of the staff of the research organization and members of the staff of the particular hospital or hospitals.
>
> The active participation in medical research by members of the staff of the particular hospital or hospitals will be considered to be evidence of such close cooperation. Because medical research may involve substantial investigation, experimentation and study not immediately connected with hospital or medical care, the requisite joint effort will also normally be found to exist if there is an established relationship between the research organization and the hospital which provides that the cooperation of appropriate personnel and the use of facilities of the particular hospital or hospitals will be required whenever it would aid such research.

Treas. Reg. § 1.170A-9(d)(2)(iii) defines "medical research" as follows:

[91] Treas. Reg. § 1.170A-9(d)(2)(v)(A) (as amended in 2020).

> Definition of medical research.
>
> Medical research means the conduct of investigations, experiments, and studies to discover, develop, or verify knowledge relating to the causes, diagnosis, treatment, prevention, or control of physical or mental diseases and impairments of man. To qualify as a medical research organization, the organization must have or must have continuously available for its regular use the appropriate equipment and professional personnel necessary to carry out its principal function. Medical research encompasses the associated disciplines spanning the biological, social and behavioral sciences. Such disciplines include chemistry (biochemistry, physical chemistry, bioorganic chemistry, etc.), behavioral sciences (psychiatry, physiological psychology, neurophysiology, neurology, neurobiology, and social psychology, etc.), biomedical engineering (applied biophysics, medical physics, and medical electronics, for example, developing pacemakers and other medically related electrical equipment), virology, immunology, biophysics, cell biology, molecular biology, pharmacology, toxicology, genetics, pathology, physiology, microbiology, parasitology, endocrinology, bacteriology, and epidemiology.

Below is an example from § 1.70A-9(d)(2)(x) of a medical research organization which spends only a very small percentage of its assets on medical research:

> O, an organizing referred to in section 170(c)(2), was created to promote human knowledge within the field of medical research and medical education. All of O's assets consist of a diversified portfolio of stocks and bonds. O's endowment earns 3.5 percent annually, which O expends in the conduct of various medical research programs in conjunction with certain hospitals. However, in 1974, O receives a substantial bequest and as a result O expends only 3.1 percent of its endowment in 1974. However, O established that it will expend at least 3.5 percent of its endowment for the active conduct of medical research for taxable years 1975 through 1978. Since O also meets the principal purpose test described in paragraph (d)(2)(iv) of this section, it is therefore an organization described in section 170(b)(1)(A)(iii) for taxable year 1975.[92]

Revenue Ruling 69-545 observed that, "[t]he promotion of health, like the relief of poverty and the advancement of education and religion, is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole." Therefore, a health care organization that does not meet the requirements of IRC section 170(b)(1)(A)(iii) may still qualify as a 501(c)(3)

[92] Other examples can be found within the same section referenced above.

Public Charity (or a foreign Public Charity equivalent). To do so, it must be organized and operated for charitable purposes and satisfy the public support test. Common examples of such organizations include health advocacy groups, nursing homes, hospices, and blood banks.[93]

4. Hospitals and Clinics

A hospital will qualify as a Public Charity under IRC § 170(b)(1)(A)(iii) if its "principal purpose or functions . . . are the providing of medical or hospital care or medical education or medical research."[94]

Although § 170 does not define "hospital," the Regulations list entities that do and do not qualify as a hospital. The examples provide a relatively broad range of institutions that can qualify, including "outpatient clinic[s]." Examples of small clinics that qualify as charitable hospitals are rural medical clinics serving the poor and women's health clinics serving those in need of maternity care. It is therefore clear that a free-clinic or a clinic that serves individuals who cannot afford traditional medical services can qualify as a "Public Charity" under the definition of a "hospital" without having to comply with the great many rules that traditional hospitals must comply with.

The following discussion should be reviewed with an understanding that a Public Charity clinic will not have to comply with all of the below-indicated rules.

Treas. Reg. § 1.170A-9(d)(1)(ii) provides the following definition of the term "hospital":

> (A) The term hospital includes -
>
> (1) Federal hospitals; and
>
> (2) State, county, and municipal hospitals which are instrumentalities of governmental units . . . . A ***rehabilitation institution, outpatient clinic, or community mental health or drug treatment center*** may qualify as a "hospital" . . . if its principal purpose or function is the providing of hospital or medical care. . . . [T]he term medical care shall include the treatment of any physical or mental disability or condition, whether on an inpatient or outpatient basis, provided the cost of such treatment is deductible . . . by the person treated. An organization, all the accommodations of which qualify as being part of a ***"skilled nursing facility"*** . . . may qualify as a "hospital" . . . if its principal purpose or function is the providing of hospital or medical care. . . . [T]he term hospital also includes ***cooperative hospital service organizations*** . . . .

[93] *Hospitals and Medical Research Organizations*, NGOsource (Nov. 1, 2017), https://www.ngosource.org/blog/hospitals-and-medical-research-organizations.
[94] I.R.C. § 170(b)(1)(A)(iii).

> (B) The term hospital does not, however, include convalescent homes or homes for children or the aged, nor does the term include institutions whose principal purpose or function is to train handicapped individuals to pursue some vocation. An organization whose principal purpose or function is the providing of medical education or medical research will not be considered a "hospital" . . . unless it is also actively engaged in providing medical or hospital care to patients on its premises or in its facilities, on an inpatient or outpatient basis, as an integral part of its medical education or medical research functions.[95]

a. Qualifying for Tax Exemption as a Hospital Under IRC § 501(c)(3)

IRS Revenue Ruling 69-545 provides that, "[t]o qualify for exemption from Federal income tax under IRC § 501(c)(3), a nonprofit hospital must be organized and operated exclusively in furtherance of some purpose considered to be 'charitable' which includes the 'promotion of health.'"[96]

Additionally, "a hospital must: [d]emonstrate that it provides benefits to a class of persons that is broad enough to benefit the community, and [o]perate to serve a public rather than a private interest."[97]

Rev. Rul. 69-545 established what is known as the "Community Benefit Standard" which is a test that the IRS uses to determine whether a hospital is organized and operated for the charitable purpose of promoting health.

Rev. Rul. 69-545 provides the following factors that will be considered in determining whether a hospital meets the Community Benefit Standard:

- The hospital operates an emergency room open to all where no one requiring emergency care is denied treatment, regardless of their ability to pay.
- The control of the hospital rests with a board of directors or board of trustees that is composed of members of the community.
- The hospital maintains an open medical staff policy.
- The hospital provides care for all patients able to pay, including those who pay their bills through public programs such as Medicaid and Medicare.
- The hospital uses surplus funds to improve the quality of patient care, expand its facilities, replace equipment, and advance medical training, education, and research.

The IRS uses an "all facts and circumstances" test when weighing these factors:

[95] Treas. Reg. § 1.170A-9(d)(1)(ii) (emphasis added).
[96] Rev. Rul. 69-545, 1969-2 C.B. 117.
[97] *Charitable Hospitals - General Requirements for Tax-Exemption Under Section 501(c)(3)*, I.R.S., https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3 (last visited June 23, 2022).

> Although no one factor is determinative in considering whether a nonprofit hospital meets the community benefit standard, the IRS weighs all the relevant facts and circumstances in evaluating these factors. Additional factors, such as whether a hospital provides financial assistance to those not able to pay, are relevant in determining whether the hospital is providing a benefit to the community.[98]

IRC § 501(r)(2)(A) defines a "hospital organization" as "an organization which operates a facility which is required by a State to be licensed, registered, or similarly recognized as a hospital" and "any other organization which the Secretary determines has the provision of hospital care as its principal function or purpose constituting the basis for its exemption under [IRC § 501(c)(3]."

Based on the factors listed in Rev. Rul. 69-545, one may consider the following questions when evaluating whether a hospital or clinic meets the community benefit standard:

- Is the hospital's board of directors made up of "prominent civic leaders" rather than exclusively hospital personnel?

- Does the hospital admit all qualified medical staff seeking privilege, consistent with the size and nature of the facilities?

- Does the hospital operate an emergency room full time that is open to all, regardless of ability to pay?[99]

- Is non-emergency care available to everyone in the community who is able to pay either privately or through third parties, including Medicare and Medicaid?

- Are there multiple classes of individuals in the community that are benefitting from the research or charity care provided by the hospital?

Additionally, charitable hospitals and other healthcare providers can evidence their commitment to the charitable purpose by providing a significant amount of charity care, which is outlined in a charity-care policy.[100] These charity-care policies must be made available to the public and typically outline when patients will be eligible for "free or reduced-cost care, often using a sliding scale, based on the patient's ability to pay."[101]

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[98] *Charitable Hospitals - General Requirements for Tax-Exemption Under Section 501(c)(3)*, I.R.S., https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3 (last visited June 23, 2022).
[99] An emergency room is not required for a clinic or specialty hospital. *See* Rev. Rul. 83-157, 1983-2 C.B. 94.
[100] Janet E. Gitterman & Marvin Friedlander, *Health Care Provider Reference Guide*, I.R.S., 15 (2004), https://www.irs.gov/pub/irs-tege/eotopicc04.pdf.
[101] Gitterman at 15.

Some of the normal billing practices used in hospital or clinic management are prohibited in the operation of charitable hospitals or clinics. These include assigning a client's debt to a collection agency before a determination has been made of whether the patient qualifies for the charitable hospital's financial assistance policy (FAP).[102] Many hospitals or clinics offer incentives to physicians or other staff in the recruitment process; this can be permitted for charitable hospitals in situations where there are staffing shortages but must be narrowly tailored to ultimately further the exempt purposes of the hospital.[103]

A hospital's activities must actually produce a community benefit. For example, in Field Service Advisory 200110030, the IRS stated that a hospital will not qualify for exemption from the community benefit standard merely by stating that its policies are designed to provide health care services for the indigent. The Operational Test under section 501(c)(3) obligates the organization seeking exempt status to engage "primarily in activities *which accomplish* one or more" exempt purposes.[104] To qualify for exemption, the hospital must demonstrate that its charity care policies actually yield significant health care services to the indigent.[105]

While the provision of free or subsidized care to the indigent is not, by itself, a determinative factor, the IRS observes that it is a significant indicator to the courts and the Service that a hospital promotes health for the benefit of the community.

b. Complying with the IRC § 501(r) Requirements for a Hospital Organization to be Treated as a 501(c)(3) Organization

In addition to the general requirements for tax exemption under § 501(c)(3) and Rev. Rul. 69-545, the Patient Protection and Affordable Care Act (The ACA), added new requirements under § 501(r) for organizations that operate one or more hospital facilities. The requirements only apply to facilities that are required by a state to be licensed, registered, or similarly recognized as a hospital. These additional requirements are:

i. Conduct a Community Health Needs Assessment ("CNHA") every three years and adopt an implementation strategy to meet the community health needs identified through the CNHA.[106]

[102] I.R.C. § 501(r)(4)(A).
[103] Gitterman at 18.
[104] Treas. Reg. § 1.501(c)(3)-1(c)(1) (as amended in 2017) (emphasis added).
[105] IRS Field Service Advisory 200110030 (citing *Redlands Surgical Services*, 113 T.C. at 86-88, and *Geisinger Health Plan*, 985 F.2d at 1219) (Analyzing prior Rev. Ruls. and case law, the Service stated that the fact a hospital has a provision for free or subsidized care to indigents is a significant factor in determining whether the community benefit standard has been met. Nevertheless, it is just a factor. The more real and pivotal evidence is whether or not the hospital actually delivered services to those of need in the community. Citing Treasury regulations, the Service emphasized that the hospital must engage in activities that accomplish an exempt purpose. Based on the above rationale, the Service concluded that a hospital's mere assertion to care for the poor is not enough. There must be actual proof of significant care to indigents in the community. Thus, the Service held it would deny exemption status to a hospital with these stated policies in accordance with Treas. Reg. § 1.501(c)(3)-1(c), unless the hospital demonstrates that such policies actually result in the delivery of significant healthcare services to the indigent).
[106] I.R.C. § 501(r)(3)(A).

The CNHA must "take[] into account input from persons who represent the broad interests of the community served by the hospital facility, including those with special knowledge of or expertise in public health."[107] Additionally, the CNHA must be "made widely available to the public."[108]

A hospital organization meets the requirements of Section 501(r)(3) with respect to a hospital facility it operates if:

- The hospital facility has conducted a CHNA in the taxable year or in either of the two immediately preceding taxable years, and

- "An authorized body of the hospital facility . . . has adopted an implementation strategy to meet the community health needs identified through the CHNA . . . on or before the 15th day of the fifth month after the end of such taxable year." [109]

ii. Establish a financial assistance policy and emergency medical care policy.

The written financial assistance policy must include the following:

(i) eligibility criteria for financial assistance, and whether such assistance includes free or discounted care,

(ii) the basis for calculating amounts charged to patients,

(iii) the method for applying for financial assistance,

(iv) in the case of an organization which does not have a separate billing and collections policy, the actions the organization may take in the event of non-payment, including collections action and reporting to credit agencies, and

(v) measures to widely publicize the policy within the community to be served by the organization.[110]

The written emergency medical care policy must require that the organization will provide, "without discrimination, care for emergency medical conditions (within the meaning of section 1867 of the Social Security Act (42 U.S.C. 1395dd)) to individuals regardless of their eligibility under the financial assistance policy described [above]."[111]

iii. "[L]imit amounts charged for emergency or other medically necessary care provided to individuals eligible for assistance under the financial assistance policy . . . to not more than the amounts generally billed to individuals who have insurance covering such care, and . . . prohibit[] the use of gross charges."

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[107] I.R.C. § 501(r)(3)(B).
[108] I.R.C. § 501(r)(3)(B).
[109] Treas. Reg. § 1.501(r)-3(a) (as corrected in 2015).
[110] I.R.C. § 501(r)(4)(A).
[111] I.R.C. § 501(r)(4)(B).

Treasury Regulation §1.501(r)-1defines gross charges as "a hospital facility's full, established price for medical care that the hospital facility consistently and uniformly charges patients before applying any contractual allowances, discounts, or deductions."

iv. "[N]ot engage in extraordinary collection actions before the organization has made reasonable efforts to determine whether the individual is eligible for assistance under the financial assistance policy."[112]

IRC § 501(r)(2)(B) provides that "[i]f a hospital organization operates more than 1 hospital facility—(i) the organization shall meet the requirements of this subsection separately with respect to each such facility, and (ii) the organization shall not be treated as described in subsection (c)(3) with respect to any such facility for which such requirements are not separately met."

[112] I.R.C. § 501(r)(6).

5. The Public Support Tests

Besides operating a school, church, or a hospital, there are two ways to become a Public Charity. Both of these methods require receiving a significant level of public support but define "support" differently.

<table>
<tr><th><u>At Least</u> One-Third Test
(IRC § 509(a)(1) and Treasury Regulation § 1.170A-9(f))</th><th>Facts and Circumstances Test
(IRC § 509(a)(1) and Treasury Regulation § 1.170A-9(f))</th><th><u>More Than</u> One-Third and <u>Not More Than</u> One-Third Test
(IRC § 509(a)(2))</th></tr>
<tr><td><u>At least one-third</u> of the organization's support must be received by way of donations from:
a United States federal or state governmental entity made for "exclusively public purposes,"
the general public, and
other Public Charities.</td><td>10% or more of its total support must come from:
governmental agencies,
contributions from the general public, and
contributions or grants from other Public Charities.</td><td>Receive <u>over one-third</u> of their income from the sum of:
donations from individuals who each contribute less than 2% of the Public Charity's income in a given year and
from gross receipts derived from activities related to the entity's tax-exempt purpose.</td></tr>
<tr><td>Contributions from donors who have donated more than 2% of the Public Charity's overall receipts cannot be used to satisfy the "At Least One-Third Public Support Test."</td><td>The facts and circumstances must indicate that it is a publicly supported organization.</td><td>The organization <u>must not receive more than one-third</u> of its support from the sum of:
its gross investment income and
the excess (if any) of the amount of its unrelated business taxable income.</td></tr>
</table>

i. At Least One-Third[113] of Support ("Donations") from Governmental Units and Under 2% Donors or Satisfy the Facts and Circumstances Test

IRC § 509(a)(1), which provides that an organization described in 170(b)(1)(A)(vi) is a Public Charity, and Treasury Regulation § 1.170A-9(f) require that an organization satisfy either a At Least One-Third Test or a Facts and Circumstances Test. To satisfy the At Least One-Third Test, at least one-third of a Public Charity's support must be received by way of a United States federal or state governmental entity made for "exclusively public

[113] The album "Thirty Three & ⅓" by George Harrison came out in 1976.

purposes," the general public, and other Public Charities. In addition, contributions from donors who have donated more than 2% of the Public Charity's overall receipts cannot be used to satisfy the "At Least One-Third Public Support Test."

To satisfy the Facts and Circumstances Test, "10% or more of its total support must come from governmental agencies, contributions from the general public, and contributions or grants from other Public Charities and the facts and circumstances [must] indicate [that this] is a publicly supported organization."[114]

ii. More Than One-Third Income ("Donations Plus Operating Revenues") from Under 2% Donors and Gross Receipts from Activities and Not More Than One-Third from Gross Investment Income and Excess UBTI.

IRC § 509(a)(2) allows Public Charity status for organizations that receive over one-third of their income from the sum of (1) donations from individuals who each contribute less than 2% of the Public Charity's income in a given year and (2) from gross receipts derived from activities related to the entity's tax-exempt purpose. The organization must not receive more than one-third of its support from "the sum of its gross investment income . . . and the excess (if any) of the amount of its unrelated business taxable income."[115]

The two tests differ in several ways, including what will be counted towards "public support" or income and what will not be. Most notably, the "More Than One-Third AND Not More Than One-Third Test" under IRC § 509(a)(2) allows gross receipts generated from activities related to an organization's tax-exempt purpose, such as admission fees and membership dues to be included in the public support test, which means that the Public Charity status will be highly dependent upon the entity generating sufficient income.

Although the "At Least One-Third Public Support Test" under Treasury Regulation § 1.170A-9(f) cannot by satisfied by income generated from related businesses or activities or from donors who donate more than 2% of the Public Charity's overall income limits, the entity is still allowed to have large donors and to receive income from other sources. These charities can engage in substantial income-generating activities that are related to their tax-exempt purpose, if the total revenue generated by such fundraising activities do not exceed two-thirds of the entity's income.

Many Public Charities can qualify under both tests listed above. However, there are benefits to a 501(c)(3) qualifying as a Public Charity under IRC § 509(a)(1) rather than under IRC § 509(a)(2). For example, organizations that are heavily endowed may not be able to pass the "Not More Than One-Third Test" under IRC § 509(a)(2)(B) because the test prohibits the organization from receiving more than one-third of its support from gross investment income. However, a heavily endowed organization is more likely able to pass the "At Least One-Third Test" under § 509(a)(1), which permits up to two-thirds support from gross investment income. In addition,

114 *Instructions for Schedule A (Form 990) 2021, Public Charity Status and Public Support*, I.R.S., 5 (Dec. 3, 2021), https://www.irs.gov/pub/irs-pdf/i990sa.pdf.
115 Treas. Reg. § 1.509(a)-3(a)(3)(i) (as amended in 2020).

gross receipts from exempt activities are included in the denominator used to satisfy the "More Than One-Third Test" under IRC § 509(a)(2)(B) but not the "At Least One-Third Test" under IRC § 509(a)(1), making it easier to satisfy the test under § 509(a)(1). [116]

iii. Special Situation: Can a charitable trust that derives $100,000 from a GoFundMe page claim Public Charity status as a 501(c)(3) organization?

In this situation, a charitable trust may be considered to be a Public Charity under 26 U.S.C. § 501 by reason of having met the "broadly supported" qualification as defined under either I.R.C. § 509(a)(1) or I.R.C. § 509(a)(2), both of which require that a significant level of public support must be received, or at least reasonably expected in the early years to satisfy one of the two "One-Thirds Tests".

a. At Least One-Third Test Applied

Under the At Least One-Third Test under I.R.C. § 509(a)(1), a charitable trust can be considered to be a Public Charity if (1) it qualifies as being one of the approved categories of "Public Charities," meaning a church, a medical research, organization, a hospital or a governmental entity, as discussed earlier in this chapter, or (2) an organization must satisfy either an At Least One-Third Test or a Facts and Circumstances Test.

The At Least One-Third Test requires that an organization receive at least one third of its total aggregate support from the government and/or the public during the prior four tax years. An organization that meets this test qualifies as a Public Charity both in the qualifying tax year (the fifth year) and the succeeding tax year (the sixth year). The IRS does not require new public charities to demonstrate public support until year six.[117] Organizations applying for this status must keep track of the contributions they receive each year so that when the sixth year arrives, they can demonstrate that contributions for the previous five years will qualify for the sixth year. After the five-year grace period, this charity will have to prove its status annually or have qualified in the previous year.

For example: Helpful Org. has $30,000 total aggregate support during Years 1 through 5. It must receive at least $10,000 from government or public sources aggregately during the five-year period to satisfy the public support test in Year 5. If it qualifies in Year 5, it will also automatically qualify in Year 6 per Treasury Regulation 1.170A-9(f)(2). This is essentially a congressional one-year grace period in case an organization meets the test in one year but fails it the next. For instance, assume Helpful Org. receives a large gift that is not from a government or public source in Year 6 and thereby fails the test for Year 6 because its government and public support in Years 2 through 6 is less than one-third of its total support. It will still be considered to satisfy the public support test in Year 6 because it met the At Least One-Third Test in Year 5. In order to meet the test in Year 7, at least one third of its total aggregate support must be received from government or public sources in Years 3 through 7.

[116] Lauren Watson Cesare, *456 T.M., Private Foundations and Public Charities — Definition and Classification, VI. Publicly Supported Organizations, B. Application of §§170(b)(1)(A)(vi) and 509(a)(2)*, Bloomberg Tax.
[117] *Id.*

Year	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Total Annual Support	$10,000	$5,000	$5,000	$5,000	$5,000	$50,000	$5,000
Government and Public Support	$0	$10,000	$0	$0	$0	$0	$0
At Least One-Third Test Met?					Yes, because government and public support over current year and prior 4 years is at least one third of total support.	No, because government and public support over current year and prior 4 years is less than one third of total support. However, it will still qualify because it qualified in the prior year.	No, because government and public support over prior 4 years is less than one third of total support. It does not qualify under the one-year grace period because it did not meet the test the prior year.

If, for whatever reason, the charity does not pass the At Least One-Third test, it could pass the Facts and Circumstances test, so long as its public support is at least 10%.[118] In order to pass the Facts and Circumstances Test, 10% or more of the charity's total support must come from governmental agencies, contributions from the public, and contributions or grants from other Public Charities, and the facts and circumstances must indicate that this is a publicly supported organization, essentially meaning that it maintains a funding program consistent with a public charity. Any charity that indicates on its Form 990 that it is a 501(c)(3) organization must file a Schedule A, *Public Charity Status and Public Support*. Part II, which contains the public support calculations is reproduced on the next page.

[118] ***Error! Main Document Only.****Gassman al., supra, at 41.et*

Schedule A (Form 990) 2022 Page **2**

Part II **Support Schedule for Organizations Described in Sections 170(b)(1)(A)(iv) and 170(b)(1)(A)(vi)**
(Complete only if you checked the box on line 5, 7, or 8 of Part I or if the organization failed to qualify under Part III. If the organization fails to qualify under the tests listed below, please complete Part III.)

Section A. Public Support

Calendar year (or fiscal year beginning in)	**(a)** 2018	**(b)** 2019	**(c)** 2020	**(d)** 2021	**(e)** 2022	**(f)** Total
1 Gifts, grants, contributions, and membership fees received. (Do not include any "unusual grants.") . . .						
2 Tax revenues levied for the organization's benefit and either paid to or expended on its behalf						
3 The value of services or facilities furnished by a governmental unit to the organization without charge						
4 **Total.** Add lines 1 through 3 . . .						
5 The portion of total contributions by each person (other than a governmental unit or publicly supported organization) included on line 1 that exceeds 2% of the amount shown on line 11, column (f)						
6 **Public support.** Subtract line 5 from line 4						

Section B. Total Support

Calendar year (or fiscal year beginning in)	**(a)** 2018	**(b)** 2019	**(c)** 2020	**(d)** 2021	**(e)** 2022	**(f)** Total
7 Amounts from line 4						
8 Gross income from interest, dividends, payments received on securities loans, rents, royalties, and income from similar sources						
9 Net income from unrelated business activities, whether or not the business is regularly carried on						
10 Other income. Do not include gain or loss from the sale of capital assets (Explain in Part VI.)						
11 **Total support.** Add lines 7 through 10						

12 Gross receipts from related activities, etc. (see instructions) **12**

13 **First 5 years.** If the Form 990 is for the organization's first, second, third, fourth, or fifth tax year as a section 501(c)(3) organization, check this box and **stop here** . . . . ☐

Section C. Computation of Public Support Percentage

14 Public support percentage for 2022 (line 6, column (f), divided by line 11, column (f)) . . . . **14** %

15 Public support percentage from 2021 Schedule A, Part II, line 14 . . . . **15** %

16a **33 1/3% support test—2022.** If the organization did not check the box on line 13, and line 14 is 33 1/3% or more, check this box and **stop here**. The organization qualifies as a publicly supported organization . . . . ☐

b **33 1/3% support test—2021.** If the organization did not check a box on line 13 or 16a, and line 15 is 33 1/3% or more, check this box and **stop here**. The organization qualifies as a publicly supported organization . . . . ☐

17a **10%-facts-and-circumstances test—2022.** If the organization did not check a box on line 13, 16a, or 16b, and line 14 is 10% or more, and if the organization meets the facts-and-circumstances test, check this box and **stop here**. Explain in Part VI how the organization meets the facts-and-circumstances test. The organization qualifies as a publicly supported organization . . . . ☐

b **10%-facts-and-circumstances test—2021.** If the organization did not check a box on line 13, 16a, 16b, or 17a, and line 15 is 10% or more, and if the organization meets the facts-and-circumstances test, check this box and **stop here**. Explain in Part VI how the organization meets the facts-and-circumstances test. The organization qualifies as a publicly supported organization . . . . ☐

18 **Private foundation.** If the organization did not check a box on line 13, 16a, 16b, 17a, or 17b, check this box and see instructions . . . . ☐

Schedule A (Form 990) 2022

b. More Than One-Third Test Applied

Another way the charitable trust could also qualify for Public Charity status is through the More Than One-Third Income test under I.R.C. § 509(a)(2). Under this test, an organization qualifies if it "normally receives more than one-third of its support in each taxable year from any combination of gifts, grants, contributions, or membership fees, and gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513), not including such receipts from any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of $5,000 or 1 percent of the organization's support in such taxable year . . . ."[119]

This test often applies to organizations that receive their support primarily from active programs, such as schools that charge tuition and museums that charge admission fees.[120] This test looks at the organization to determine whether more than one-third of its income (Donations and Operating revenues) originates from the sum of donations from individuals who each contribute less than 2% of the Public Charity's income in a given year and from gross receipts derived from activities related to the entity's tax-exempt purpose. This test is also to be applied over a five-year cumulative period. Ultimately, this test differs from the At Least One-Third Test because it allows for gross receipts generated from activities related to the organization's tax-exempt purpose to be included in the calculation.

In conclusion, a 501(c)(3) organization will likely meet the Broadly Supported Public Charity qualification through the At Least One-Third Test or the More Than One-Third Income Test, so long as it can prove that over one-third of its donations originate from donors whose donations do not exceed 2% of the charity's overall receipts, when measured for a cumulative period of 5 years. Following these principles will also help when transforming a for-profit business into a not-for-profit for the purpose of receiving government help or other grants that would otherwise not be available.

Questions that must be answered on Schedule G, *Successors to Other Organizations*, of Form 1023 - "Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code" application for tax exempt status for an entity that is converting from for profit to 501(c)(3) are as follows:

1. List the name, last address, and EIN of your predecessor organization and describe its activities.
2. List the owners, partners, principal stockholders, officers, and governing board members of your predecessor organization. Include their names, addresses, and share/interest in the predecessor organization (if for-profit).
3. Are you a successor to a for-profit organization? If "Yes," explain your relationship with the predecessor organization that resulted in your creation and explain why you took over the activities or assets of a for-profit organization or converted from for-profit to nonprofit status; continue to Line 4.

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[119] ***Error! Main Document Only.****26 U.S.C. § 509(a)(2)(A)(i)(ii).*

[120] ***Error! Main Document Only.****Kathryn Okimoto, Public Support Test - Why It Matters for Both Public Charities and Private Foundations, Clark Number, (June 8, 2021) https://clarknuber.com/articles/public-support-test-why-it-matters-for-both-public-charities-private-foundations/.*

4. Explain your relationship with the other organization that resulted in your creation and why you took over the activities or assets of another organization.
5. Do or will you maintain a working relationship with any of the persons listed in question 2 or with any for-profit organization in which these persons own more than a 35% interest? If "Yes," describe the relationship.
6. Were any assets transferred, whether by gift or sale, from the predecessor organization to you? If "Yes," provide a list of assets, indicate the value of each asset, explain how the value was determined, and attach an appraisal, if available. For each asset listed, also explain if the transfer was by gift, sale, or combination thereof and describe any restrictions that were placed on the use or sale of the assets.
7. Were any debts or liabilities transferred from the predecessor for-profit organization to you? If "Yes," provide a list of the debts or liabilities that were transferred to you, indicating the amount of each, how the amount was determined, and the name of the person to whom the debt or liability is owed.
8. Will you lease or rent any property or equipment to or from the predecessor organization or any [owners, partners, principal stockholders, officers, and governing board members of your predecessor organization] or a for-profit organization in which these persons own more than a 35% interest? If "Yes," describe the arrangement(s) including how the lease or rental value was determined.

6. Advertising to Meet the One-Third Test

A 501(c)(3) may meet the 509(a)(1) one-third test by spending an amount equal to more than one-third of the entity's income in advertising to attract donations. For example, if the founding donor gives $500,000 a year and the organization spends $300,000 a year to attract just over $250,000 of other donations, then the net cost of being a Public Charity is just under $50,000 a year. This may make the donor's gifts worthwhile because the donor will be able to donate appreciated real estate and other assets—not only securities—to the charity and receive a deduction based upon fair market value. The advertising which generates less revenues than it costs will also increase the general public's awareness of the charity's mission.

Many charities have annual fundraising events that break even while attracting new donors and supporters and enabling the charity to meet the one-third test. One-third of a loaf is better than no loaf at all—but not during Passover when unleavened donations can be considered.

7. Community or Subject Matter Foundations

In addition to family-controlled Public Charities, a Community Foundation, which may be location-based or subject-matter-based or cause-based, may be attractive to donors who would like to achieve specific actions or help people, animals in need, or other causes without having the complexity or compliance costs associated with a family-controlled charity. Community Foundations can receive donations of money, buildings, or other assets and will be inclined to follow the donors' instructions and to actually help the donor understand the law and philanthropic opportunities at a relatively low cost. Examples of Community Foundations include not only location-based foundations but also organizations such as the National Christian Foundation and the Jewish Federation of North America.[121] These organizations may be willing to allow for subsidiary companies to operate in the same manner as a Public Charity without the limitations that apply to a Private Operating Foundation.

Israel

Mexico

Canada

Regarding location-based charitable organizations, it is important to note that contributions to foreign charities are generally not tax deductible. However, tax treaties between the United States and Israel, Canada, and Mexico permit charitable deductions for contributions to some organizations in those countries. For example, for United States tax purposes, a United States citizen or resident may claim as a charitable contribution donation to qualifying Israeli charities amounting to 25% of the taxpayer's Israeli source income. An Israeli resident may similarly claim as a charitable contribution donation to qualifying United States charities.

8. <u>Supporting Organizations and Creditor Protection for Charitable Organizations</u>

A Supporting Organization must spend money or provide the use of assets to one or more 501(c)(3) organizations, and it is best for this to be paid on an annual, or more frequent, basis. A supporting organization is not permitted to engage in activities other than those that support or benefit the supported organization or other organizations that have the same purposes.

There are three types of Supporting Organizations. The nickname and a brief description from the IRS of each type are as follows:

Type I: "Operated, Supervised, or Controlled By"	"A Type I [S]upporting [O]rganization must be operated, supervised or controlled by its supported organization(s), typically by giving the supported organization(s) the power to regularly appoint or elect a majority of the directors or trustees of the [S]upporting [O]rganization. The relationship between the supported organization(s) and the [S]upporting [O]rganization is sometimes described as similar to a parent-subsidiary relationship."[122]

[121] https://jewishfederations.org/how-we-help/planned-giving.

[122] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.

Type II: “Supervised or Controlled in Connection With”	“A Type II [S]upporting [O]rganization must be supervised or controlled in connection with its supported organization(s), typically by having a majority of the directors or trustees of the supported organization(s) serve as a majority of the trustees or directors of the [S]upporting [O]rganization. The relationship between the supported organization(s) and the [S]upporting [O]rganization is sometimes described as similar to a brother-sister relationship.”[123]
Type III: “Operated in Connection With”	“A Type III [S]upporting [O]rganization must be operated in connection with one or more publicly supported organizations. All [S]upporting [O]rganizations must be responsive to the needs and demands of, and must constitute an integral part of or maintain significant involvement in, their supported organizations. Type I and Type II [S]upporting [O]rganizations are deemed to accomplish these responsiveness and integral part requirements by virtue of their control relationships. However, a Type III [S]upporting [O]rganization is not subject to the same level of control by its supported organization(s). Therefore, in addition to a notification requirement, Type III [S]upporting [O]rganizations must pass separate responsiveness and integral part tests.”[124]

A Supporting Organization must meet the following 3 requirements:

> (A) [The organization] is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more [organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii))] or [organizations that pass the more than one-third public support test],
>
> (B) [The organization] is—
>
> (i) operated, supervised, or controlled by one or more organizations [described in section 170(b)(1)(A) (other than in clauses (vii) and (viii))] or [organizations that pass the more than one-third public support test],
>
> (ii) supervised or controlled in connection with one or more such organizations, or
>
> (iii) operated in connection with one or more such organizations, and

[123] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.
[124] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.

(C) [The organization] is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations [described in section 170(b)(1)(A) (other than in clauses (vii) and (viii))] or [organizations that pass the more than one-third public support test].[125]

One purpose of Supporting Organizations is to allow assets donated or held for the benefit of an active 501(c)(3) charity to be held in a separate organization that could be controlled to a certain extent by separate officers and directors. Although it does not meet the requirements of a Public Charity, a qualifying Supporting Organization is treated as a Public Charity because it is organized and operated exclusively for the benefit of one or more Public Charities.

Many donors and charitable entity officers view a Supporting Organization as being the ultimate piggy bank to hold investments for an active charity, keep them safe from the charity's creditors and spending tendencies, and possibly to lighten the operating charity's balance sheet so that it can qualify for grants and support.

Many such individuals and advisors are not aware of the requirement that a Supporting Organization must pass an operational test that requires it to do something significant on an ongoing basis for its dedicated charity or other appropriate charitable entities or causes.

It is acceptable for a 501(c)(3) organization that has an annual surplus from fundraising or the profit from its charitable and non-charitable activities to place funds or invest into a Supporting Organization. It is also acceptable for the Supporting Organization to spend only a small percentage of the value of its assets on expenses that the charitable organization would have paid for or to provide money for activities that are consistent with the purposes of the charitable organization being supported.

For example, ABC Charity may be a public charity engaged in medical research and may have an annual surplus of $1,000,000 a year.

It transfers the $1,000,000 each year to a Supporting Organization that has been established for the primary purpose of supporting ABC.

The charitable organization may spend 1% of its net worth each year by giving funds to ABC Charity or a related 501(c)(3) organization that are used to provide scholarships for university students who are specializing in microbiology, medicine, or nursing. Not only does this provide scholarships for worthy individuals, but it also enhances the reputation of ABC Charity with students and professors and allows ABC to be better able to attract employees to work for it.

The primary purposes of Supporting Organizations are as follows:

1. Assets can be held separate and apart from the active entity in order to be insulated from liabilities of the active entity, such as if someone physically injured in a charitable activity sues the active entity and receives a large judgment. The

[125] I.R.C. § 509(a)(3) (1969).

Supporting Organization and its assets would not be subject to the judgment. The active charitable organization could file bankruptcy, eliminate the debt, and continue to operate with the continued financial support of the Supporting Organization.

Note that the Bankruptcy Code provides special protection for nonprofit corporations. Bankruptcy Code § 303(a) provides that creditors of a nonprofit corporation may not commence an involuntary bankruptcy case against the organization. Bankruptcy Code § 1112(c) prohibits the forced liquidation of a nonprofit corporation.

2. A donor of a Supporting Organization can participate in (or name individuals or a trust company to participate in) the investment management of the Supporting Organization and the decisions as to how much and when the Supporting Organization will transfer monies to the active charity.

3. An active charity that is supported by a well-endowed Supporting Organization may be able to receive more governmental support and grants because it does not have to show the Supporting Organization's assets on its balance sheet. Grant applications should be carefully prepared so that the existence of the Supporting Organization is disclosed, if and when appropriate.

4. The tax benefits of donating and operating a Public Charity (the ability of a donor to deduct up to 30% of adjusted gross income for the donation of any kind of appreciated capital gain assets and up to 50% of adjust gross income—or 60% of adjusted gross income for cash gifts only) apply both to Public Charities and Type I, Type II, and Type III Supporting Organizations that support them.

   Supporting Organizations are not subject to the self-dealing rules. However, the Pension Protection Act of 2006[126] subjected all Supporting Organizations to the excise taxes imposed on excess benefit transactions under IRC § 4958.[127]

   In addition, "grant making" Type III Supporting Organizations are subject to the minimum distribution requirements and excise taxes on excess business holdings. Type II supporting organizations are also subject to the excess business holdings rules if they accept contributions from a person who directly or indirectly controls a supported charity, a family member[128] of such a person, or an entity controlled 35% or more by such a person.

[126] Pub. L. No. 109-280.

[127] "The term 'excess benefit transaction' means any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit." I.R.C. § 4958(c)(1)(A).

[128] "For purposes of [this section], the family of any individual shall include only his spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren." I.R.C. § 4946(d).

Excise Taxes	Type I Supporting Organization	Type II Supporting Organization	Type III Supporting Organization
Excess Benefit Transactions	Applies	Applies	Applies
Excessive Lobbying	Applies	Applies	Applies
Political Expenditures	Applies	Applies	Applies
Excess Business Holdings	Does not apply	Applies if the Supporting Organization accepts a contribution from a donor who controls the organization	Applies if the Supporting Organization is not functionally integrated[129]
Minimum Payout Requirements	No	No	Yes
Can Receive IRA Qualified Distributions	No	No	No

9. <u>Advantages of Public Charities</u>

Unlike Private Foundations and Private Operating Foundations, Public Charities can enter into arm's-length transactions with individuals who are considered to be "Disqualified Persons" under IRC § 4946 if the charitable entity was instead a Private Foundation. (Disqualified Persons and the self-dealing rules are discussed in Chapter 4.) This provides significantly increased flexibility in operating a Public Charity and a related for-profit business versus a Private Foundation, which could not enter into any transaction with a Disqualified Person. A company or other entity that is owned 99% by a Public Charity should be able to borrow funds from the Public Charity on an arm's-length basis, if necessary. Although the interest rate for such a loan would be higher than what would be expected under a "friendly" loan, the interest income would go to the Public Charity that the donor effectively controls, and the donor may deduct interest payments made to the 501(c)(3).

[129] "[A] Type III supporting organization . . . will be treated as functionally integrated, if it:
(1) Supports at least one supported organization that is a governmental entity to which the supporting organization is responsive within the meaning of §1.509(a)-4(i)(3); and
(2) Engages in activities for or on behalf of the governmental supported organization described in paragraph (1) that perform the functions of, or carry out the purposes of, that governmental supported organization and that, but for the involvement of the supporting organization, would normally be engaged in by the governmental supported organization itself." I.R.S., Notice 2014-4, 2014-2 I.R.B. 274 (Jan. 6, 2014).

Public Charity Support Organizations. "Public Charity Support Organizations" ("PCSO") refers to 501(c)(3) organizations that are willing to accept donations and enter into arrangements with donors and affiliates of donors at the request of a Public Charity.

A typical large Public Charity or donor advised fund sponsor would not want to accept stock in closely held companies, real estate that may have environmental issues or ownership interest in companies or other entities that cannot be controlled by the charity. S-Corporation stock can be owned by a charity but because of the high income tax bracket (100% on S-Corporation K-1 and Capital Gains Income, and income from the sale or redemption of S-Corporation stock) that charities must pay on S-Corporation income, they will commonly refuse to accept a donation thereof.

Many of these conservative public charities have relationships with smaller well-tuned 501(c)(3) organizations that are willing to accept such donations and arrangements, and honor the requests made by donors to give monies derived from rent, interest, dividends, or the eventual sale of such assets to the originally intended public charity.

10. Donor Advised Funds (DAFs)

In one case involving Donor Advised Fund, a client transferred 98.6% of their ownership in a commercial property LLC into a Trust. The Trust was a 501(c)(3) company recommended by the sponsor of the Donor Advised Fund that only accepts cash and appreciated marketable securities on its platform. The Trust charged $10,000 a year to receive the net income from the LLC and transfer that net income over to the Donor Advised Fund.

The client asked whether it was possible to have his family limited partnership purchase the property at fair market value. In other words, the question is whether the donor can buy an asset from said public charity for fair market value.

A public charity can sell assets to an affiliate of a donor, or even the donor herself, but this must be reported on an IRS Form 8282, *Donee Information Return*, if the purchase occurs within three years of the donation.

Congress has imposed several excise taxes on transactions with Donor Advised Funds:

IRC 4966 Taxable Distributions: This rule imposes an excise tax on any distribution from a donor advised fund to a natural person. It also imposes an excise tax on any distribution for a non-charitable purpose,[130] or over which the sponsoring organization does not exercise expenditure responsibility,[131] from a donor advised fund to a person or entity other than (1) an entity that can

[130] IRC 170(c)(2)(B) lists the following as charitable purposes: religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.

[131] The expenditure responsibility rule is found in IRC 4945(h) requires the exertion "of all reasonable efforts and to establish adequate procedures—

receive deductible charitable contributions,[132] (2) the donor advised fund's sponsoring organization, or (3) another donor advised fund. The excise tax imposed on the sponsoring organization is 20% of any taxable distribution and an additional 5% tax, up to $10,000, imposed upon a fund manager who makes the transaction knowingly.

IRC 4967 Prohibited Benefit Transactions: This section imposes an excise tax on any distribution that results in a donor-advisor, donor, or related party receiving a "more than incidental benefit" directly resulting from his advice. The excise tax is equal to 125% of the benefit received and is imposed on both the advisor and the person who received the benefit. Any sponsor manager who agreed to the distribution with knowledge that it conveyed a more than incidental benefit is subject to a 10% tax. Whether the benefit is "more than incidental" is determined by whether the benefit would have reduced a charitable contribution deduction if the donor had made a contribution to the sponsoring organization and received the same benefit.

It can be argued that the distribution of an asset that results in a benefit to a donor-advisor is effectively part-gift, part-sale. The relative risk would be amplified if the fair market value calculation is based on heavily discounting the asset interest.

IRC 4958(c)(2): This section makes it an automatic excess benefit transaction for there to be any "grant, loan, compensation, or other similar payment" from a Donor Advised Fund to a donor-advisor. The entire amount paid is considered to be the amount of the excess benefit.

Payments pursuant to bona fide sales are not automatic excess benefit transactions under 4958(c)(2), however, such transactions are subject to the other provisions of 4958, meaning the donor or related entity or person must pay fair market value for the property. Otherwise the property would qualify as an excess benefit transaction under the definition provided in IRC 4958(c)(1): which reads as follows: "any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit."

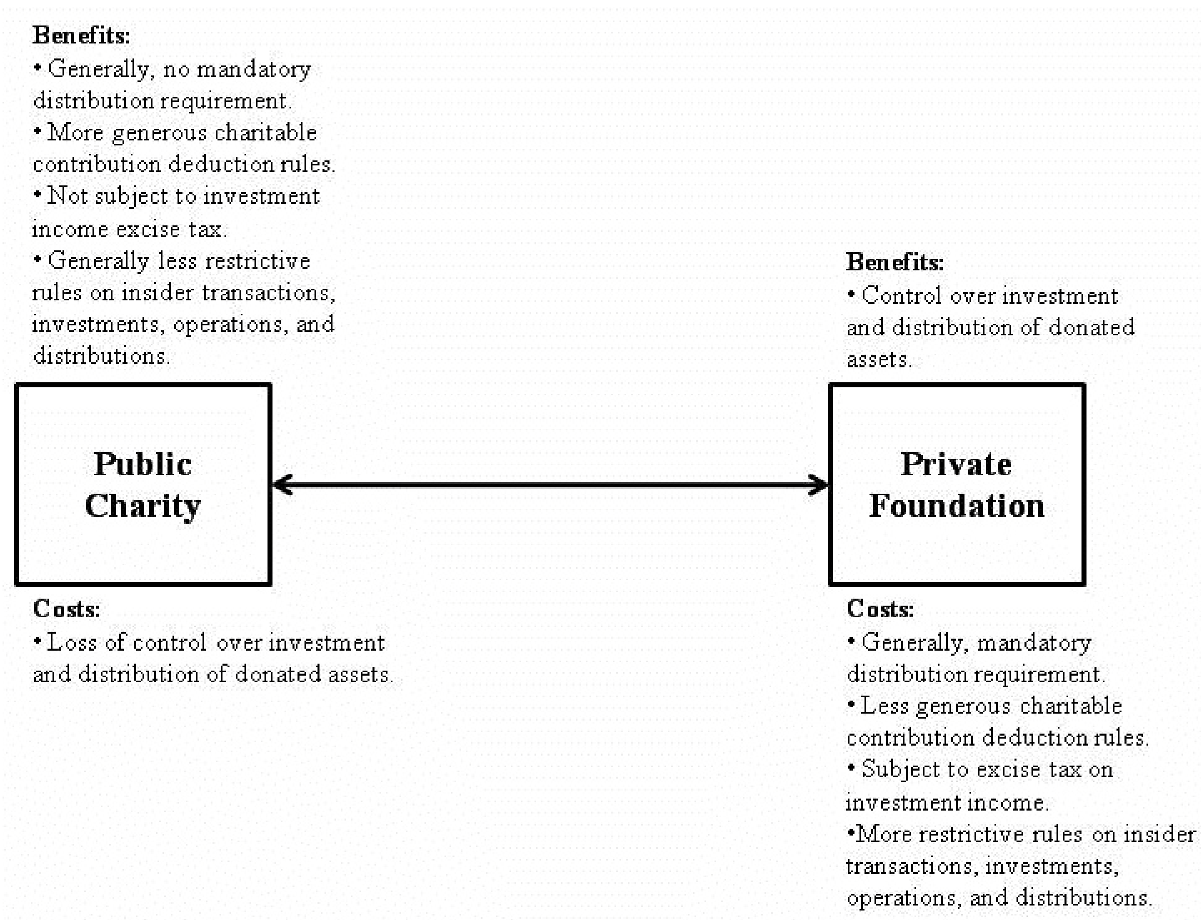
C. Private Operating Foundations

In a December 2011 report to Congress, the Treasury Department provided the following discussion and chart that explains the benefits of Public Charities over Private Foundations:

(1) to see that the grant is spent solely for the purpose for which made,
(2) to obtain full and complete reports from the grantee on how the funds are spent, and
(3) to make full and detailed reports with respect to such expenditures to the Secretary."

[132] Applicable entities are listed in IRC 170(b)(1)(A).

> [The following chart] illustrates, from a donor's perspective, the tradeoffs between establishing a public charity and establishing a private foundation. Generally, in exchange for less restrictive rules governing transactions with insiders, more generous charitable contribution deduction limits, and no distribution requirements, donors to public charities give up all control over the donated assets and generally do not control the charity. At a private foundation, donors may control the foundation and thus be able to maintain a certain amount of influence over the donated assets, but the foundation is subject to an excise tax on investment income, operational restrictions, a mandatory distribution requirement, and less generous charitable deduction rules.[133]



[Public Charity donation rules apply for Private Operating Foundations.]

[133] *Report to Congress on Supporting Organizations and Donor Advised Funds*, Department of the Treasury, 13-14 (Dec. 2011), https://home.treasury.gov/system/files/131/Report-Donor-Advised-Funds-2011.pdf.

Many donors want to exert as much control as possible over an active charitable entity that they contribute to, so the Private Operating Foundation is often the entity of choice.

Contributions made to a Private Operating Foundation enjoy the same higher deductibility limits and the ability to deduct the fair market value of appreciated assets that applies for Public Charities.

In fact, a Private Operating Foundation controlled by a taxpayer can receive IRA transfers (Qualified Charitable Distributions) of up to \$100,000 from a taxpayer who has reached age 70½ and qualified for the 100% of adjusted gross income (AGI) cash contribution amount that was permitted in 2021.[134]

Unlike a Private Non-Operating Foundation, which is generally known as a "Private Foundation," a Private Operating Foundation must have an active charitable activity or activities that make it "active." This could include providing scholarship programs where the Private Operating Foundation's personnel evaluate candidates, interview them, provide scholarship monies and guidance, monitor academic and professional progress, and provide mentorship and recognition.

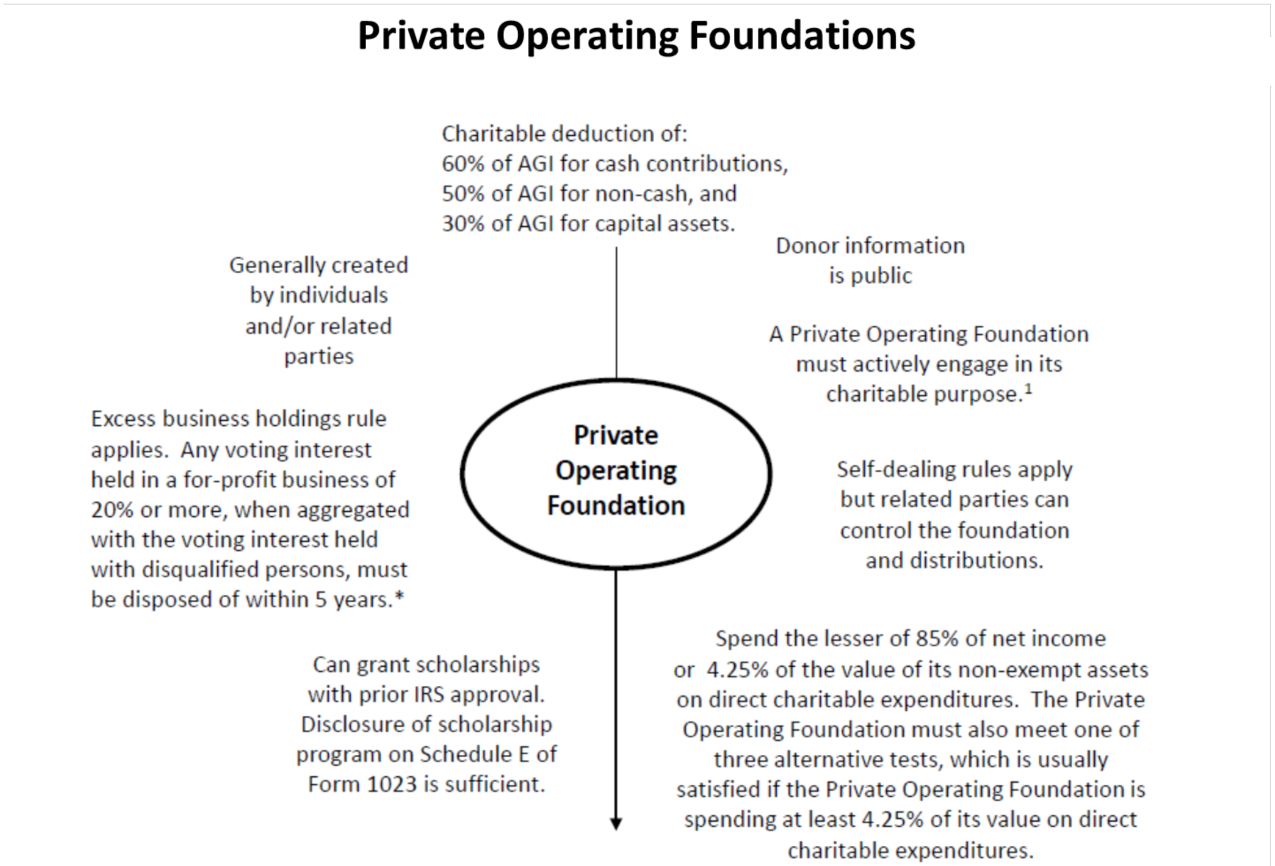
A Private Operating Foundation can be controlled by a single donor or the donor's family, as compared to a typical Public Charity, which will normally have a Board of Directors, Managers, or Trustees that the primary donors do not control. The IRS will generally not approve tax-exempt status for a Public Charity that is controlled by a donor, but the conversion of a Private Foundation or a Private Operating Foundation controlled by a donor to a Public Charity will normally be permitted. It is noteworthy, however, that the IRS will typically permit a Private Operating Foundation to convert to a Public Charity when it qualifies, even though it is controlled by a single individual or donor's family.

Unlike a Public Charity, however, a Private Operating Foundation is subject to many related-party rules, which generally prevent the donor and the donor's family from having any financial dealings with the Private Operating Foundation, other than to loan money to it tax-free, to provide space on a rent-free basis, and to receive compensation for services rendered.

A founder or major donor can buy or sell assets to or from a Public Charity, rent space for fair-market-value rent, and otherwise have transactions and financial relationships with the Public Charity, so long as the private inurement and other arm's-length rules are followed.

A Private Operating Foundation is also subject to the 1.39% of net investment income tax and the 4.25% of fair-market-value distribution requirements.

[134] *Expanded Tax Benefits Help Individuals and Businesses Give To Charity In 2021*, I.R.S. (Sept. 28, 2021), https://www.irs.gov/newsroom/expanded-tax-benefits-help-individuals-and-businesses-give-to-charity-in-2021. The 100% of Adjusted Gross Income for cash contribution was a temporary rule that did not apply to contributions to Private Non-Operating Foundations or Charitable Remainder Trusts.



1. Private Operating Foundations Are Subject to Several Limitations That Do Not Apply To Public Charities

(1) The 4.25% Per Year Expenditure Requirement

Private Operating Foundations have an obligation to distribute, set aside, and/or spend at least 4.25% of the value of the organization's assets at least 3 out of every 4 taxable years,[135] beginning in the second year of existence (for Private Non-operating Foundations, the first payment begins in the first year of existence).

The 4.25% may be funded in whole or in part from operating income of the foundation. For example, if the foundation operates a thrift shop that breaks even, the expenses of this thrift shop will count towards the 4.25% of value payment, so that no endowment assets of the organization will have to be spent.

a. Frequency of Valuation:

[135] I.R.C. § 4942(j)(3)(A) requires Private Operating Foundations to distribute "substantially all of the lesser of its adjusted net income (as defined in subsection (f)), or its minimum investment return," as defined by Treas. Reg. § 53.4942(b)-1(c) as 85% or more.

The value of cash held by a foundation is calculated by taking the average of the beginning and ending balances of the foundation's cash accounts for each month during a given tax year. The value of publicly traded securities held by the foundation can be found by taking the average of the month-end balances of such securities for each month during the tax year. All other assets have their values determined annually. For real estate, however, if the foundation obtains a certified independent appraisal of the value, it may use that value for up to five tax years.

b. Set Aside Exception:

The 4.25% annual distribution requirement can also be satisfied by "setting aside" assets for charitable use, such as by committing to construct or otherwise add improvements to a building or complex used for charitable purposes, or by spending revenues derived from the operation of a charitable activity on the foundation's operating expenses.

For example, a foundation with $20 million dollars of assets may wish to build an aquatic center in a neighborhood where children in need will be the primary users. If the aquatic center will cost $5 million, then the foundation may put a "set aside resolution" in to its books and will be considered to have spent the $5 million over a period of years to eliminate the need to otherwise satisfy the 4.25% minimum tax test.

A set aside application can be filed on IRS Form 8940, *Request for Miscellaneous Determination* (attached as Exhibit C). The following is derived from IRS webpages published in September of 2021 on the set aside rules:

> An amount set aside for a specific project may be treated as a qualifying distribution in the year set aside (but not in the year actually paid) if at the time of the set-aside the foundation establishes to the satisfaction of the Service that:
>
> 1. The amount will actually be paid for the specific project within 60 months from the date of the first set-aside, and
>
> 2. The set-aside satisfies the suitability test, that is, that the project is one that can be better accomplished by a set-aside than by immediate payment, or the foundation satisfies the cash distribution test.[136]
>
> ---
>
> To satisfy the suitability test, the foundation must show that the specific project for which the amount is set aside is one that can be better accomplished by the set-aside than by the

[136] *Set-Asides*, I.R.S., (Mar. 18, 2022), https://www.irs.gov/charities-non-profits/private-foundations/set-asides.

immediate payment of funds. Such a project includes, but is not limited to, situations where relatively long-term grants or expenditures must be made to assure the continuity of particular charitable projects or program-related investments, or where grants are made as part of a matching-grant program.

An example of a specific project is a plan to build an art museum even though the exact location and architectural plans have not been finalized. For good cause shown, the period for paying the amount set aside may be extended by the Service.

To qualify under the suitability test, a set-aside must be approved by the IRS.[137]

The [F]oundation satisfies the cash distribution test if:

1. The specific project for which the amount is set aside will not be completed before the end of the tax year in which the set-aside is made,

2. The foundation actually distributes for exempt purposes, in cash or its equivalent, the start-up period minimum amount during the foundation's start-up period, and

3. The foundation actually distributes the full-payment period minimum amount in each tax year of the foundation's full-payment period.

New foundations may find the cash distribution test useful as they assess how much they will actually distribute for start-up projects.[138]

Although Service approval is not required for set asides qualifying under the cash distribution test, the foundation must attach [the following] to its annual return for any tax year in which amounts are set aside . . . :

[137] *Suitability Test: Private Foundation Set-Aside*, I.R.S., (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/suitability-test-private-foundation-set-aside.
[138] *Cash Distribution Test: Private Foundation Set-Asides*, I.R.S., (Mar. 18, 2022), https://www.irs.gov/charities-non-profits/private-foundations/cash-distribution-test-private-foundation-set-asides.

1. A statement describing the nature and purposes of the specific project for which amounts are set aside,

2. A statement that the amounts set aside will actually be paid for the specific project within a specified period that ends no more than 60 months after the date of the set-aside,

3. A statement that the project will not be completed before the end of the tax year in which the set-aside is made,

4. A statement showing the distributable amounts for any past tax years in the foundation's start-up and full-payment periods, and

5. A statement showing the total amount of actual payments in cash or its equivalent for exempt purposes during each tax year in the foundation's start-up and full-payment periods. This statement should include a detailed description of any corrective or other payments that are treated, according to the rules discussed earlier, as distributed during a tax year prior to the tax year in which actually made, and should explain the circumstances that justify the application of those rules.

The foundation must also attach to its annual return for each of the five tax years following the tax year in which the amount is set aside (and for each tax year in any extended period for paying the amount set aside) the statements described in (4) and (5) above.[139]

A set-aside approved by the Service or that meets the cash distribution test should be shown by entering a dollar amount on the books of the foundation as a pledge or obligation to be paid at a future date or dates. Any amount set aside will be taken into account in figuring the foundation's minimum investment return and any income from the set-aside should be taken into account in figuring the adjusted net income of Private Operating Foundations. The amount set aside need not reflect an accumulation of income, but may be a

[139] *Statement Required for Cash Distribution Test: Private Foundation Set-Aside*, I.R.S., (May 4, 2022), https://www.irs.gov/charities-non-profits/private-foundations/statement-required-for-cash-distribution-test-private-foundation-set-aside.

bookkeeping entry that will require funding out of corpus by the end of the set-aside period.[140]

If a Private Foundation is involved in litigation and may not distribute assets or income because of a court order, it may seek and obtain a set-aside for the purpose of making a qualifying distribution. The amount that may be set aside is equal to the part of the foundation's distributable amount that is attributable to the assets or income held under the court order that would otherwise have been distributed.

If the litigation lasts more than one tax year, the foundation may seek additional contingent set-asides. The amounts must actually be distributed by the last day of the tax year following the tax year in which the proceedings end. Amounts the foundation does not distribute by the end of that year will be considered gross income to the foundation for the following tax year.[141]

(1) Must Pay Net Investment Income Tax of 1.39%

Private Foundations have an obligation to pay 1.39% of the organization's annual net investment income, which is defined as the amount by which the sum of "gross investment income" (the gross amount of income from interest, dividends, rents, payments with respect to security loans, royalties, and capital gain net income) exceeds expenses paid or incurred in the production or collection of gross investment income or for the management of property held for the production of gross investment income.

Until December 20, 2019, this was a 2% tax unless the Private Foundation met certain requirements, in which event it was a 1% tax. On average, organizations were paying approximately 1.39% so Congress wisely simplified the tax for all concerned.

(2) Arms-Length Transactions with Disqualified Persons Not Permitted

Other than interest-free loans and rent-free use of properties provided by a donor or other Disqualified Person to a Private Operating Foundation, and the payment of reasonable compensation for personal management and skilled services rendered, there can be no transactions between a Private Operating Foundation and a Disqualified Person. This limitation does not apply to Public Charities.

2. Considering Conversion to a Public Charity

[140] *Evidence Of Set-Aside By Private Foundation*, I.R.S., (Feb. 17, 2022), https://www.irs.gov/charities-non-profits/private-foundations/evidence-of-set-aside-by-private-foundation.
[141] *Contingent Set-Aside - Private Foundation*, I.R.S., (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/contingent-set-aside-private-foundation.

The conversion process to change a Private Foundation to a Private Operating Foundation, or a Private Operating or Non-Operating Foundation to a Public Charity is surprisingly easy.

Oftentimes, it will be best to convert a Private Foundation to a Private Operating Foundation. A Private Operating Foundation may also be converted to a Public Charity.

Non-profit entities can change classification at any time by making whatever financial and activity adjustments are necessary to meet the classification criteria, and filing a Form 8940, *Request for Miscellaneous Determination* (attached as Exhibit C), along with all information, documentation, and other materials required by the Form and its Instructions, as well as paying the $500 user fee.

In general, the entity will simply have to meet the qualifications of the type of entity that it wants to be qualified as. The Form 8940 simply provides the IRS with notice that the entity will meet those standards on a going forward basis. There are several considerations that should be considered when deciding whether to convert from one entity type to another.

For example, Public Charities are not subject to the same self-dealing and Private Foundation restrictions as a Private Operating Foundation. If a Public Charity converts to a Private Operating Foundation, it may find itself to be in violation of several restrictions that apply to Private Operating Foundations. Before converting to a Private Operating Foundation, a Public Charity should consult a well-qualified attorney to ensure that its operations will not cause any problems.

The entity also needs to make a realistic evaluation as to whether it can meet the requirements of the desired classification on a going forward basis. Many Private Foundations do not have any significant public support and have not conducted any substantial active charitable activities.

3. Possible Benefits to be Derived from Charitable Real Estate Related Activities

The following are examples of possible benefits that may be incidentally enjoyed by real estate developers from working with 501(c)(3) organizations:

Example #1: Developer Supports Charitable Lender[142]

A developer supports a lending company which is registered as a 501(c)(3) organization and will loan money to individuals who wish to buy condominiums or single-family homes from the developer or affiliates of the developer but are unable to qualify for funding.

The 501(c)(3) loans provide the borrower a 20% down payment at closing and are

[142] This example is based on The Mueller Foundation in Austin, Texas. Information about the Mueller Foundation comes their website, https://muellerfoundation.org/.

subordinate to the bank or financial institution that provides first mortgage financing and private mortgage insurance ("PMI").

Under the loan arrangement, the 501(c)(3) will recoup the amounts that it has advanced, along with interest and a percentage of the excess of the eventual sales price of the home over what the 501(c)(3) organization advanced.

Interest income received by a charity that is actively engaged in the business of lending to help needy borrowers may be excluded from being taxable as income. In Revenue Ruling 79-349, 1972-2 C.B. 233, a charity that was actively making mortgage loans and receiving interest income received confirmation that the interest income would be excluded from UBTI under IRC § 512(b)(1).

It is important to note that charging interest is permitted but the interest rate should be relatively low or zero to show charitable intent. It is important that the 501(c)(3) balance factors such as whether a person could have afforded the home or whether the person's income/resources met the qualifications for the loan.

The organization ensures that the homeowners it supports have financial need and that it follows all federal, state, and Treasury Regulation nondiscrimination and record-keeping guidelines.

The developer has an incidental yet substantial economic benefit by being able to sell units to individuals who would otherwise not have been able to afford them and, the developer received a tax deduction for contributions to the entity.[143]

Example #2: Developer Donates Building and Retains Management Control

A real estate developer/landlord who owns a building adjacent to a hospital campus would like to donate the building to receive a charitable deduction for the fair market value of the building, which has been completely depreciated using straight-line depreciation over the last 40 years.

The building is leased at arm's length to for-profit tenants that are not affiliated with the developer or any 501(c)(3) organizations.

The leases in the building will be structured so that the landlord will only provide services to the tenants that are the responsibility of the landlord in a typical lease agreement, such as repairs of the exterior spaces and common areas, normal maintenance, landscaping, and payment of taxes and insurances.

The landlord/donor also has a small office in the building.

The landlord/donor establishes a 501(c)(3) Private Operating Foundation that will

[143] Applications will typically, at least indirectly, allude to the possibility that residents of a gated or similar community may negatively perceive the presence of economically disadvantaged individuals.

engage in interviewing and selecting non-licensed employees of the system who wish to become licensed nurses. The foundation will provide employees with scholarships so that they may take classes. The classes will be given by a separate 501(c)(3) school that is operated by a local community college.

The Foundation has rent-free use of an office in the building, with pro rata sharing of expenses for utilities, janitorial services, and other amenities. The landlord/donor and his for-profit organization will not have further use of the Foundation's office but may still maintain use of the other parts of the building.[144]

The landlord/donor's daughter will manage the property and receive arm's-length management fees or a salary. The net rent income of the 501(c)(3) will generally not be taxable because of the exception for passive income under the UBTI rules,[145] assuming that there is no debt on the building or that one of the exceptions to the unrelated business income tax for leveraged properties applies.[146]

Example #3: Developer Establishes Aquatic Center or Other Community Benefit Center in or Nearby the Area being Developed

A developer wishes to have a world-class aquatics and community center within the borderlines of the general area that the developer and affiliates own and develop.

The recreational center will cost more than $20 million, and it has the support of the county government. It has given assurances that individuals who do not reside within the boundaries of the development will have equal access to the center. The center will have special programs for children, teenagers, and adults to provide swimming lessons in the State where most drownings occur (Florida) and air-conditioned recreational space in a Mid-Florida city that often has average summer temperatures in the high 90s and large portions of the population do not have air conditioning or would "hang out with bad influences otherwise."

The developer is also providing pools and recreational centers separate from the 501(c)(3)-owned-and-operated facility in its community. One of them is only approximately a fifth of a mile from the 501(c)(3) center.

The application for tax-exempt status mentions that it is believed that most of the residents who live in "over-55" sections of the community will prefer to use their nearby pool

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[144] Renting property to a Private Foundation by a Disqualified Person could be considered self-dealing, even if the lease is for below-fair-market-value rent. *See* I.R.C. § 4941(d)(1)(C). In order for a Disqualified Person to rent property directly to a Private Operating Foundation under the zero-rent lease exception to the prohibited transactions rules, the Disqualified Person landlord is not allowed to receive any rent but may receive reimbursement of certain costs and may require the Private Operating Foundation to pay insurances, taxes, and maintenance costs. These restrictions are strictly enforced by the IRS with the interpretation that any benefit received by a Disqualified Person results in a prohibited transaction.

[145] I.R.C. § 512(b)(1) and Treas. Reg. § 1.512(b)-1(c) exclude rents from real property from UBTI (where personal property does not make up a significant portion of the rental amount). There are exceptions to this exception, so care must be taken with any form of passive income.

[146] Treas. Reg. § 1.514(c)-1(b)(3)(ii)-(iii).

and recreational center as opposed to making use of the busier and commonly integrated 501(c)(3) center.

The 4.25% of value annual minimum distribution requirement will be satisfied in the first years by the spending of money to build the recreational center and improvements. From then on, the value of the recreational center will not be included in the 4.25% expenditure requirement, and amounts spent to operate and maintain the recreational center can count towards the 4.25% expenditure requirement, while revenues from admissions, support from the government, and grants from other organizations do not enter into the calculation.

The fact that the sole donor to the Private Operating Foundation has common ownership with the developer company and owns significant properties within the vicinity of the center does not necessarily disqualify the donor for the charitable deduction or the 501(c)(3) organization for approval under the private inurement rules.

4. <u>Arm's-Length Terms are Essential</u>

When entering into any transaction with a Disqualified Person, it is advisable for the Public Charity to document that such transaction is being entered into at arm's length and to keep adequate records to prove that the Disqualified Person is not receiving any additional benefit from transacting directly with the Public Charity in excess of what such person would receive in a transaction with an unrelated party. If the Public Charity provides the Disqualified Person with a benefit that would not generally be given to the general public, such as a discount or more favorable terms, then the Public Charity could be penalized for unjustly benefitting private interests and in extreme cases could lose its tax-exempt status.

5. <u>The Quid Pro Quo Test</u>

Not all transfers of property made by an investor or developer to a bona fide charity will qualify for an income tax deduction.

Under the Quid Pro Quo Test, the receipt of payments or value derived from a gift may result in a limited or completely denied deduction.

An example of this is the 1983 federal Court of Appeals case *Ottawa Silica Co. v U.S.*,[147] where Ottawa Silica Co. intended to develop a large parcel of rural land to become residential housing and donated property for a new high school to be built by the local school board. The court determined that the company expected to receive a substantial economic benefit in exchange for the transfer: faster development of surrounding acreage and additional access roads to be built by the government.

The court cited *Singer Co. v United States*,[148] in which the Singer sewing machine company sold sewing machines to schools at below the fair market value of the machines but

[147] 699 F.2d 1124 (Fed. Cir. 1983).
[148] 449 F.2d 413 (1971).

was found by the court to expect future increased sales as the result of having students use the machines.

Oftentimes, contributors to charity receive positive publicity that builds public goodwill. Under Revenue Ruling 68-432, 1968-2 C.B. 104, such public benefits are considered to be insubstantial for purposes of determining whether the charitable deduction should be reduced as the result of private benefits.

As another example, in Revenue Ruling 69-90, 1969-1 C.B. 63, charitable contributions were made by merchants who leased space in a building and donated money to facilitate the construction of unrestricted public parking facilities. The Service ruled that the merchants could receive charitable income tax deductions because they were not directly helped by the parking.

6. <u>Charity or Business Expense – It Must Be One or the Other</u>

In Revenue Ruling 72-314, 1972-1 C.B. 44, the IRS indicated that "[w]hether payments . . . are 'contributions or gifts[]' . . . depends upon whether such payments are completely gratuitous or whether they bear a direct relationship to the taxpayer's business and are made with a reasonable expectation of a financial return commensurate with the amount of the payment."

In the 1969 U.S. Tax Court Memorandum Opinion *Scheffres v. Commissioner*,[149] a real estate partnership that planned to build apartments on a tract of land agreed to transfer a portion of the land to the local school board in lieu of selling it to a private party. An official from the school board testified that the board would have purchased the land if it had not been donated. The court found that, even though donating the land probably resulted in goodwill for the developer, there was no economic benefit when the land was donated rather than sold or condemned. The donation was treated as a charitable contribution as opposed to a business expense.

7. <u>Private Inurement / Excess Benefit Rule</u>

The rule against private inurement, also known as excess benefit transactions, is provided under Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii):

> [A 501(c)(3)] organization is not organized or operated exclusively for [exempt] purposes . . . unless it serves a public rather than a private interest. Thus, . . . it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

[149] T.C. Memo 1969-41 (T.C. Feb. 26, 1969).

Private inurement occurs when an insider of a charitable organization takes the organization's assets, such as by being paid compensation from the organization that is more than what is reasonable or by receiving loans from the organization at low interest rates. In the words of IRC § 4958, an "excess benefit transaction" is "any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit."

IRC § 4958 imposes excise taxes on both the insider and the organization's managers on the amount of the excess benefit. There is an initial tax of 25% of the excess benefit on the insider and a separate 10% excise tax on any organization manager who knew that the transaction was an excess benefit transaction and who willingly and without reasonable cause permitted the transaction. An additional 200% excise tax is imposed on the insider if the excess benefit is not corrected within the taxable year.

In Revenue Ruling 70-186, 1970-1 C.B. 128, a nonprofit organization was established to preserve a lake and to enhance the condition of its water and recreational features. The IRS determined that the organization served a public purpose rather than a private interest, notwithstanding the benefit provided to the lakefront property owners:

> The benefits to be derived from the organization's activities flow principally to the general public through the maintenance and improvement of public recreational facilities. Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

There are also private inurement concerns when a taxpayer obtains a benefit from donating property and then seeks a charitable deduction for his or her contribution.

In the 2020 U.S. Tax Court Memorandum Opinion *Emanouil v. Commissioner*,[150] the court allowed a developer to claim a charitable income tax deduction for the donation of property to a local town, although he might not have been able to secure the town's approval of a proposed development plan without making the donation. The court found that there was not sufficient evidence to show that the transfer was necessary to receive the governmental approval, although it may have been a close call.[151]

[150] T.C. Memo 2020-120 (T.C. Aug. 17, 2020).
[151] *See also Costello v. Commissioner*, T.C. Memo 2015-87 (T.C. May 6, 2015), where the transfer of a land

The 1988 Tax Court Memorandum decision *McConnell v. Commissioner*[152] held that the transfer of streets and sewers to a local municipality was not a charitable contribution because it was made "to avoid responsibility for future maintenance and to enhance the value of the developer's remaining property."[153]

In PLR 9447028 (August 25, 1994), the transfer of property to a state for the construction of a highway was found to be deductible, where the developer's remaining property already had reasonable road access and planned roads to be built by the developer would provide residents with access to existing roads. There were no zoning changes or governmental concessions that were contingent on the donation. The Ruling pointed out that construction of the highway would produce a public benefit.

DuVal v. Commissioner[154] and *Morton v. Commissioner*[155] also confirmed that developers can receive charitable income tax deductions for donating property that can improve the value or performance of the remaining development.

In *DuVal*, the developer donated four acres of raw land to be used by the county to build a library. The developer had been an advocate of education. While it would appear that certain payments made by a taxpayer in business would qualify as being both a charitable expense and a business expense for deductibility purposes, the IRS has indicated that an expense must be one or the other and that the taxpayer cannot choose which a particular payment will be.

D. Private Non-Operating Foundations

Much has been written about Private Foundations that do not have sufficient activities to be considered to be "operating." Most non-Public Charities fall under the category of Private Non-Operating Foundations. These organizations can receive appreciated marketable securities in the same manner as Private Operating Foundations and charities, but appreciated marketable securities donated to a Private Non-Operating Foundation will be deductible based upon the lesser of its taxable basis or fair market value. Only publicly traded securities can be donated for a fair-market-value deduction to a Non-Operating Foundation, subject to a 20%-of-adjusted-gross-income limitation applicable to individual donors.

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preservation easement by a developer was found to be in exchange for permission from the county to sell development rights. *See also Dunlap v. Commissioner*, T.C. Memo 2012-126 (T.C. May 1, 2012) and *McGrady v. Commissioner*, T.C. Memo 2016-233 (T.C. Dec. 22, 2016).

[152] T.C. Memo 1988-307 (July 21, 1988) (affirmed by unpublished Opinion of the 3rd Circuit Court of Appeal in 1989).

[153] *Id.* at 9.

[154] T.C. Memo 1994-603 (Dec. 12, 1994).

[155] T.C. Memo 1979-484 (Dec. 5, 1979).

When publicly traded securities are gifted to a Private Non-Operating Foundation, the contribution base can be 50% instead of 30% if the gift value of such securities is reduced to the income tax basis.

The rules do not prevent a Private Non-Operating Foundation from having active charitable options or from converting to a Private Operating Foundation.

A transfer of money from a Private Non-Operating Foundation to another charity is referred to as a grant. Private Non-Operating Foundations are typically grant-making-only foundations. As with Private Operating Foundations, Private Non-Operating Foundations must meet annual minimum distribution requirements or they will be subject to large excise taxes.

E. Requesting a Prompt Determination of Tax-Exempt Status

Under Revenue Procedure 2022-5, § 4.09, a nonprofit entity that has a high risk of losing a grant or promised pledge unless it can receive tax exempt status by a certain deadline can apply for accelerated recognition. Some advisors will have a related party agree to donate a certain amount or asset to the nonprofit entity if it receives approval by a certain date, and then disclose this on the Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) (attached as Exhibit B) while requesting expedited approval.

F. Charitable Remainder Trusts

Charitable Remainder Trusts are another vehicle that donors can use for tax planning and charitable purposes. If applicable rules are followed, Charitable Remainder Trusts (CRTs) allow a donor to transfer assets into an irrevocable trust and receive annual payments for a period not to exceed 20 years, the lifetime of one beneficiary, or the joint lifetime of two or more beneficiaries. The math works like this:

CRUT Illustration- $1,000,000 Contribution

Analysis of Hypothetical Charitable Remainder Trust
(20 Year Term - 8% Growth)

1	3	4	5	6	7	8	9	10	11
Year	CRUT Ending Balance (Assumes 8% Growth)	Distribution to Family (10.8% of Account Balance)	Taxes on Distribution	Net Distribution to Family	Charitable Tax Deduction Benefit	Cummulative Net Distributions to Family	Total Value Family Receives (Includes Tax Deduction Benefit)	Total Amount Charity Receives at End of Twenty Year Term	Total Amount Family Receives if CRUT Distributions are Reinvested at 6%
1	$ 972,000	$ 108,000	$ (27,404)	$ 80,596	$ 40,800	$ 80,596	$ 121,396	$ -	$ 80,596
2	$ 944,784	$ 104,976	$ (26,637)	$ 78,339	$ -	$ 158,935	$ 199,735	$ -	$ 162,917
3	$ 918,330	$ 102,037	$ (25,891)	$ 76,146	$ -	$ 235,081	$ 275,881	$ -	$ 247,111
4	$ 892,617	$ 99,180	$ (25,166)	$ 74,014	$ -	$ 309,095	$ 349,895	$ -	$ 333,332
5	$ 867,624	$ 96,403	$ (24,461)	$ 71,941	$ -	$ 381,036	$ 421,836	$ -	$ 421,740
6	$ 843,330	$ 93,703	$ (23,776)	$ 69,927	$ -	$ 450,963	$ 491,763	$ -	$ 512,500
7	$ 819,717	$ 91,080	$ (23,111)	$ 67,969	$ -	$ 518,932	$ 559,732	$ -	$ 605,787
8	$ 796,765	$ 88,529	$ (22,464)	$ 66,066	$ -	$ 584,998	$ 625,798	$ -	$ 701,779
9	$ 774,455	$ 86,051	$ (21,835)	$ 64,216	$ -	$ 649,214	$ 690,014	$ -	$ 800,663
10	$ 752,771	$ 83,641	$ (5,681)	$ 77,960	$ -	$ 727,174	$ 767,974	$ -	$ 918,176
11	$ 731,693	$ 81,299	$ (3,071)	$ 78,228	$ -	$ 805,402	$ 846,202	$ -	$ 1,041,761
12	$ 711,206	$ 79,023	$ (2,985)	$ 76,038	$ -	$ 881,440	$ 922,240	$ -	$ 1,169,262
13	$ 691,292	$ 76,810	$ (15,495)	$ 61,315	$ -	$ 942,754	$ 983,554	$ -	$ 1,288,338
14	$ 671,936	$ 74,660	$ (18,944)	$ 55,715	$ -	$ 998,470	$ 1,039,270	$ -	$ 1,407,697
15	$ 653,121	$ 72,569	$ (18,414)	$ 54,155	$ -	$ 1,052,625	$ 1,093,425	$ -	$ 1,531,393
16	$ 634,834	$ 70,537	$ (17,898)	$ 52,639	$ -	$ 1,105,264	$ 1,146,064	$ -	$ 1,659,683
17	$ 617,059	$ 68,562	$ (17,397)	$ 51,165	$ -	$ 1,156,429	$ 1,197,229	$ -	$ 1,792,836
18	$ 599,781	$ 66,642	$ (16,910)	$ 49,732	$ -	$ 1,206,162	$ 1,246,962	$ -	$ 1,931,135
19	$ 582,987	$ 64,776	$ (16,436)	$ 48,340	$ -	$ 1,254,502	$ 1,295,302	$ -	$ 2,074,873
20	$ 566,664	$ 62,963	$ (15,976)	$ 46,986	$ -	$ 1,301,488	$ 1,342,288	$ 566,664	$ 2,224,358

CRUT

No Planning - Investment of Net Sales Proceeds in Hypothetical Investment Account and Receive Distribution Each Year

11	12	13	14	15	16
Balance of Hypothetical Investment Account (Assumes 8% Growth)	Distribution (Distribution Net of Taxes Equals After Tax CRUT Payment each year)	Taxes (1.00% of Assets)	Ending Balance of Hypothetical Investment Account	Cummulative Net Distributions	Total Amount Received by Family (Net account + Cummulative Net Distributions)
$ 809,600	$ 89,340	$ (8,744)	$ 776,285	$ 89,340	$ 865,624
$ 776,285	$ 86,723	$ (8,384)	$ 743,280	$ 176,063	$ 919,343
$ 743,280	$ 84,173	$ (8,027)	$ 710,542	$ 260,236	$ 970,778
$ 710,542	$ 81,688	$ (7,674)	$ 678,024	$ 341,924	$ 1,019,948
$ 678,024	$ 79,264	$ (7,323)	$ 645,679	$ 421,188	$ 1,066,867
$ 645,679	$ 76,900	$ (6,973)	$ 613,460	$ 498,088	$ 1,111,548
$ 613,460	$ 74,594	$ (6,625)	$ 581,317	$ 572,682	$ 1,153,999
$ 581,317	$ 72,344	$ (6,278)	$ 549,200	$ 645,027	$ 1,194,227
$ 549,200	$ 70,147	$ (5,931)	$ 517,057	$ 715,174	$ 1,232,231
$ 517,057	$ 83,544	$ (5,584)	$ 469,293	$ 798,718	$ 1,268,012
$ 469,293	$ 83,296	$ (5,068)	$ 418,472	$ 882,015	$ 1,300,487
$ 418,472	$ 80,557	$ (4,519)	$ 366,873	$ 962,572	$ 1,329,445
$ 366,873	$ 65,277	$ (3,962)	$ 326,984	$ 1,027,849	$ 1,354,833
$ 326,984	$ 59,247	$ (3,531)	$ 290,365	$ 1,087,095	$ 1,377,460
$ 290,365	$ 57,291	$ (3,136)	$ 253,167	$ 1,144,387	$ 1,397,553
$ 253,167	$ 55,373	$ (2,734)	$ 215,312	$ 1,199,760	$ 1,415,072
$ 215,312	$ 53,490	$ (2,325)	$ 176,722	$ 1,253,250	$ 1,429,972
$ 176,722	$ 51,641	$ (1,909)	$ 137,310	$ 1,304,891	$ 1,442,201
$ 137,310	$ 49,823	$ (1,483)	$ 96,989	$ 1,354,714	$ 1,451,703
$ 96,989	$ 48,034	$ (1,047)	$ 55,666	$ 1,402,748	$ 1,458,414

CRUT

Summary Columns

24	25	26	27	28	29	30	31
Year	Total Received By Family Under CRUT (Column 9)	Total Received by Family Under Hypothetical Investment Account (Column 16)	Total Received by Family Under Hypothetical Investment Account with Charitable Contributions (Column 23)	Difference in Amount Family Receives if No Charitable Planning (Column 27-26)	Difference in Amount Family Receives if Charitable Distributions Made Each Year (Column 28-26)	Total Amount Charity Receives Under CRUT	Total Tax Savings if CRUT is Used
1	$ 121,396	$ 865,624	$ 858,294	$ 744,228	$ 736,898	$ -	$ 171,740
2	$ 199,735	$ 919,343	$ 904,682	$ 719,608	$ 704,947	$ -	$ 153,487
3	$ 275,881	$ 970,778	$ 948,786	$ 694,897	$ 672,905	$ -	$ 135,623
4	$ 349,895	$ 1,019,948	$ 990,625	$ 670,053	$ 640,730	$ -	$ 118,131
5	$ 421,836	$ 1,066,867	$ 1,030,214	$ 645,031	$ 608,378	$ -	$ 100,993
6	$ 491,763	$ 1,111,548	$ 1,067,564	$ 619,785	$ 575,801	$ -	$ 84,190
7	$ 559,732	$ 1,153,999	$ 1,102,685	$ 594,267	$ 542,953	$ -	$ 67,704
8	$ 625,798	$ 1,194,227	$ 1,135,581	$ 568,428	$ 509,783	$ -	$ 51,519
9	$ 690,014	$ 1,232,231	$ 1,166,255	$ 542,217	$ 476,241	$ -	$ 35,616
10	$ 767,974	$ 1,268,012	$ 1,194,705	$ 500,037	$ 426,731	$ -	$ 35,519
11	$ 846,202	$ 1,300,487	$ 1,219,850	$ 454,284	$ 373,647	$ -	$ 37,516
12	$ 922,240	$ 1,329,445	$ 1,241,477	$ 407,205	$ 319,237	$ -	$ 39,050
13	$ 983,554	$ 1,354,833	$ 1,259,534	$ 371,278	$ 275,980	$ -	$ 27,517
14	$ 1,039,270	$ 1,377,460	$ 1,274,831	$ 338,190	$ 235,561	$ -	$ 12,104
15	$ 1,093,425	$ 1,397,553	$ 1,287,593	$ 304,128	$ 194,168	$ -	$ (3,173)
16	$ 1,146,064	$ 1,415,072	$ 1,297,782	$ 269,008	$ 151,718	$ -	$ (18,337)
17	$ 1,197,229	$ 1,429,972	$ 1,305,351	$ 232,743	$ 108,122	$ -	$ (33,409)
18	$ 1,246,962	$ 1,442,201	$ 1,310,249	$ 195,239	$ 63,288	$ -	$ (48,410)
19	$ 1,295,302	$ 1,451,703	$ 1,312,421	$ 156,401	$ 17,119	$ -	$ (63,364)
20	$ 1,342,288	$ 1,458,414	$ 1,311,801	$ 116,126	$ (30,487)	$ 566,664	$ (78,292)

A Charitable Remainder Trust can pay either a fixed annual percent of its assets (as a Charitable Remainder Unitrust (CRUT)) or a fixed annual dollar amount (as a Charitable Remainder Annuity Trust (CRAT)) to non-charitable beneficiaries for a term of years, until the death of an individual, or until the death of the survivor of two or three individuals. The CRT must then distribute the remaining assets to a charity of the donor's choice at the end of the term. It must provide that the present value of the assets passing to charity at the end of its term must equal at least 10% of the value of the contributed assets. IQCalculators.com has built an easy-to-use CRUT calculator that is free to use on their website: https://iqcalculators.com/calculator/charitable-remainder-trust/.

Important Characteristics of CRATS and CRUTS		
	CRAT	**CRUT**
Minimum Annual Payment	Yes	No
Pays Greater Amounts if Values Increase	No	Yes
Annual Valuations Required	No	Yes
Complexity of Annual Valuation and Payment	No	Yes
Payments Can Be Deferred (NIMCRUT and Flip-NIMCRUT)	No	Yes
"5% Probability of Exhaustion Test" Applies	Yes	No
10% Minimum Remainder Requirement	Yes	Yes

A CRUT is normally preferred when it is expected that the value of assets will grow over time at a rate higher than the 7520 rate, which is 4.6% as of January 2023. A CRAT will be better for the non-charitable-payment recipient to ensure that a reduction in value of assets will not have a negative economic impact on the non-charitable payee.

The donor is entitled to a charitable income tax deduction in the year the contribution is made. The deduction is based on the regulation-determined tables that provide the value of the portion of the trust's assets that are expected to pass to charity at the end of the non-charitable term of the CRT.

However, transferring property subject to debt to the CRT can put its tax-exempt treatment at risk because any payment of the debt by the CRT will cause it to be considered a Grantor Trust. This will cause the loss of the CRT's statutory benefits and defeat the tax planning strategies. Even if the tax strategies are no longer viable, it is likely that the charity will still have a vested interest in the remainder and will likely require the Trustee to manage the trust appropriately.

Most CRTs are Charitable Remainder Unitrusts (CRUTs). A CRUT must provide for payments of a fixed percentage of the net fair market value of the property under the trust, valued and paid annually, to be made to one or more non-charitable beneficiaries. The percentage must be at least 5% per year but can be no more than 50% per year of the value of the trust assets based upon IRS table calculations. The CRUT is not subject to the "5% Probability of Exhaustion Test" described below. If the section 7520 rate is less than 5%, always use the CRUT.

A CRAT must provide for a fixed dollar amount of no less than 5% (but no more than 50%) of the initial net fair market value of the property contributed to the trust.

The "5% Probability of Exhaustion Test" only applies to CRATs, whereby there must be less than a 5% chance that the Trust assets will be exhausted before the end of the term, based upon the IRS table calculations. If the CRAT fails this Test, then no charitable deduction will be allowed.

Both a CRAT and a CRUT can be established during the lifetime of the settlor or upon death. The annuity or unitrust payments received by the non-charitable beneficiary generally are subject to income tax on a "worst first" basis [i.e., ordinary income and short-term capital gains of the trust first, then § 199A sheltered ordinary income (which may be taxed at 80% of ordinary income rates), then depreciation recapture, then long term capital gains and qualified dividends, etc.].[156]

Although a charitable remainder trust is not a § 501(c)(3) charity, it is tax exempt and is subject to most of the rules and restrictions applicable to Private Foundations, including the self-dealing rules, unless no charitable income tax or gift tax deduction is taken at formation or during the term of the CRT, as described below and in PLRs 201714002 (April 7, 2017) and 201714003 (April 7, 2017). Taxpayers can avoid receiving an income tax deduction by making a police benevolent association or cemetery association an allowable remainder beneficiary of the trust. Taxpayers can avoid qualifying for a gift tax deduction by having the CRUT formed and funded by an irrevocable trust that is disregarded for income tax purpose and permits the establishment of a CRUT. Unfortunately, the IRS has put this valuable planning technique on

[156] I.R.C. § 664(b)(1)-(4).

the no ruling list for PLR purposes and was refusing to issue rulings for a period of time before this became official.

CRTs are subject to a 100% excise tax on UBTI, but rent income derived from real estate can qualify for an exception from these rules, although the exceptions become complicated if and when there is a debt on the subject property.

Charitable trusts can be set to pay annually, semiannually, quarter-annually, or monthly.

Payment percentages under a Charitable Remainder Unitrust or fixed dollar amounts under Charitable Remainder Annuity Trust cannot change from year to year in the same way that Grantor Retained Annuity Trust payments can increase by 20% a year.

It is essential that the trust be properly managed, and that the payments be made on schedule.

Failure to adhere to the required formalities could cause disqualification of the Charitable Remainder Trust back to the date of formation.

This was the result in the 2002 Eleventh Circuit case *Estate of Atkinson v. Commissioner*,[157] where the taxpayer did not make payments and the IRS prevailed in asserting that the trust could not qualify as a Charitable Remainder Unitrust, notwithstanding that it was properly drafted, signed, and funded. The taxpayer lost her charitable deduction and had to pay income tax on the Charitable Remainder Trust income, as if she had retained the assets that the Charitable Remainder Trust sold and had received the income that the Charitable Remainder Trust received.

A donor who transfers appreciated property to a charitable remainder trust does not recognize gain, unless the assignment of income doctrine applies,[158] and the transfer does not result in income to the donor at the time of the transfer. However, trust income is taxable to income beneficiaries on a "worst first" basis when it is distributed and all trust income must be distributed before amounts of any other character can be distributed.

1. <u>Deferral of Ordinary Income on the Sale of Inventory</u>

In the 2022 Tax Court opinion, *Furrer v. Commissioner*,[159] a husband and wife were farmers who were advised by an advertisement in a farming magazine (and apparently by someone who sold them annuity contracts) to form Charitable Remainder Annuity Trusts and transfer part of their crop inventory to the trusts.

The couple formed two CRATs to which they transferred corn and soybeans from their farm. The CRATs sold the crops and used most of the proceeds to purchase Single Premium Immediate Annuities that made annual annuity payments to the farmers.

[157] 309 F.3d 1290 (11th Cir. 2002).
[158] See discussion of assignment of income assets under "Funding a Charitable Remainder Trust" below.
[159] T.C. Memo 2022-100 (Sept. 28, 2022).

The Tax Court, in a well-written opinion, found that the couple was not entitled to a charitable contribution deduction for the value of the corn and soybeans because they had no basis in the crops. The crops were inventory ("held primarily for sale to customers in the regular course of a trade or business") and thus ordinary income property. As such, the charitable deduction was limited to the couple's basis in the crops, which was zero because the couple had fully expensed the farming costs on their income tax returns.

The CRAT also had a basis of zero in the crops because the couple's basis was zero and they did not pay any gift tax on the transfer. When the CRATs sold the crops, the entire sale constituted ordinary income that was accumulated within the trust and not taxable to the donors in the year of sale. While CRATs are exempt from tax and do not have to pay income tax on the sale of appreciated property, the income beneficiaries must pay income tax on distributions when paid to them by the CRAT. The character of the distributions must follow an ordering regime that is set forth under IRC § 664(b) and has been described as "worst comes out first":

> (b) Character of distributions. Amounts distributed by a charitable remainder annuity trust or by a charitable remainder unitrust shall be considered as having the following characteristics in the hands of a beneficiary to whom is paid the annuity . . . :
>
> ii.First, as amounts of income (other than gains, and amounts treated as gains, from the sale or other disposition of capital assets) includible in gross income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years;
>
> [Income that qualifies for the 20% deduction under IRC § 199A for qualified business income will come out after ordinary income that does not qualify for the § 199A deduction.]
>
> iii.Second, as a capital gain to the extent of the capital gain of the trust for the year and the undistributed capital gain of the trust for prior years;
>
> iv.Third, as other income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years; and
>
> v.Fourth, as a distribution of trust corpus.
>
> For purposes of this section, the trust shall determine the amount of its undistributed capital gain on a cumulative net basis.

The Tax Court held that the distributions to the couple must be considered ordinary income because the ordinary income realized by the CRAT from the sale of the crops must be distributed first under the 664(b) ordering rules and the amount distributed to the couple was less than the amount of income that the trust realized in the crop sale.

2. Funding a Charitable Remainder Trust

A Charitable Remainder Trust is well suited to receive ownership of appreciated assets before they are sold.

As noted above the Charitable Remainder Unitrust does not pay taxes on the sale of assets or on income received. Instead, the income stores up in the Charitable Remainder Unitrust and becomes subject to income tax when received from the Charitable Remainder Unitrust by the payment beneficiaries.

The income comes out "worst first," such as in the following example:

- John transfers appreciated stock, taxable bonds, and tax-free bonds to a Charitable Remainder Unitrust before he has any obligation to sell any of these assets.
- The Charitable Remainder Trust sells the appreciated stock that was acquired by John more than 1 year before it was sold by the trust, thus triggering capital gains income of $200,000.
- In the first year the trust received $2,000 of ordinary interest income, $2,000 of dividends, and $10,000 of tax-free income from municipal bonds.
- The trust distributes $11,000 to John.
- John is considered to have received $2,000 of interest income, $2,000 of dividend income, and $7,000 of capital gains income.

Not all assets are well suited to be placed under a Charitable Remainder Trust.

Problems can arise under the following situations:

1. S corporation stock—A Charitable Remainder Trust is a not a permissible S corporation shareholder. The S election of an S corporation will be lost if ownership is transferred in whole or in part to a Charitable Remainder Trust.

2. Assignment of income assets—If a contributor to a Charitable Remainder Trust has a legally binding obligation to sell an asset, then the sale of the asset by the Charitable Remainder Trust will cause income to the donor. It is therefore important to make contributions of assets to a Charitable Remainder Trust before there is any legally binding obligation to fund the trust.

3. 100% tax rate on Unrelated Business Taxable Income—Congress does not want Charitable Remainder Trusts to be "in business" or to take on debt and therefore wrote the Unrelated Business Income Tax to require Charitable Remainder Trusts to pay a 100% tax on income from business activities.

This includes income reported by K-1 by a partnership interest held by a Charitable Remainder Trust.

The following types of income are not considered to be Unrelated Business Taxable Income unless they flow to the Charitable Remainder Trust via Partnership K-1 or are attributable to debt owed against the income producing asset. (see Chapter 4 for further discussion of UBTI and its exclusions):

a. Capital gains from the sale of assets not considered to be inventory for sale in the course of a business

b. Rent income derived from the rental of real estate that is not measured by reference to profitability or revenues of the tenant—a small portion of such rent may also be attributable to simultaneous and connected income from rental of tangible non-real-estate assets, such as furniture and equipment that a landlord might include under a lease arrangement.

c. Interest and dividends

d. Royalties

e. Income from certain non-charitable research activities

3. 2022 Development: Charitable Remainder Trust Provision That Allows Choice Between Paying Unitrust Amount to Spouse or Charity Caused Loss of Both Marital and Charitable Deduction

In Chief Counsel Advice Memorandum 202233014, published on August 19, 2022, the IRS analyzed a Charitable Remainder Unitrust that provided for a conventional remainder interest to charity, and a somewhat unconventional annual payment "unitrust" provision that required 25% of the annual unitrust amounts to be paid to the surviving spouse of the grantor, and 75% to be paid to charity and/or the grantor's surviving spouse, as determined in the discretion of the trustee.

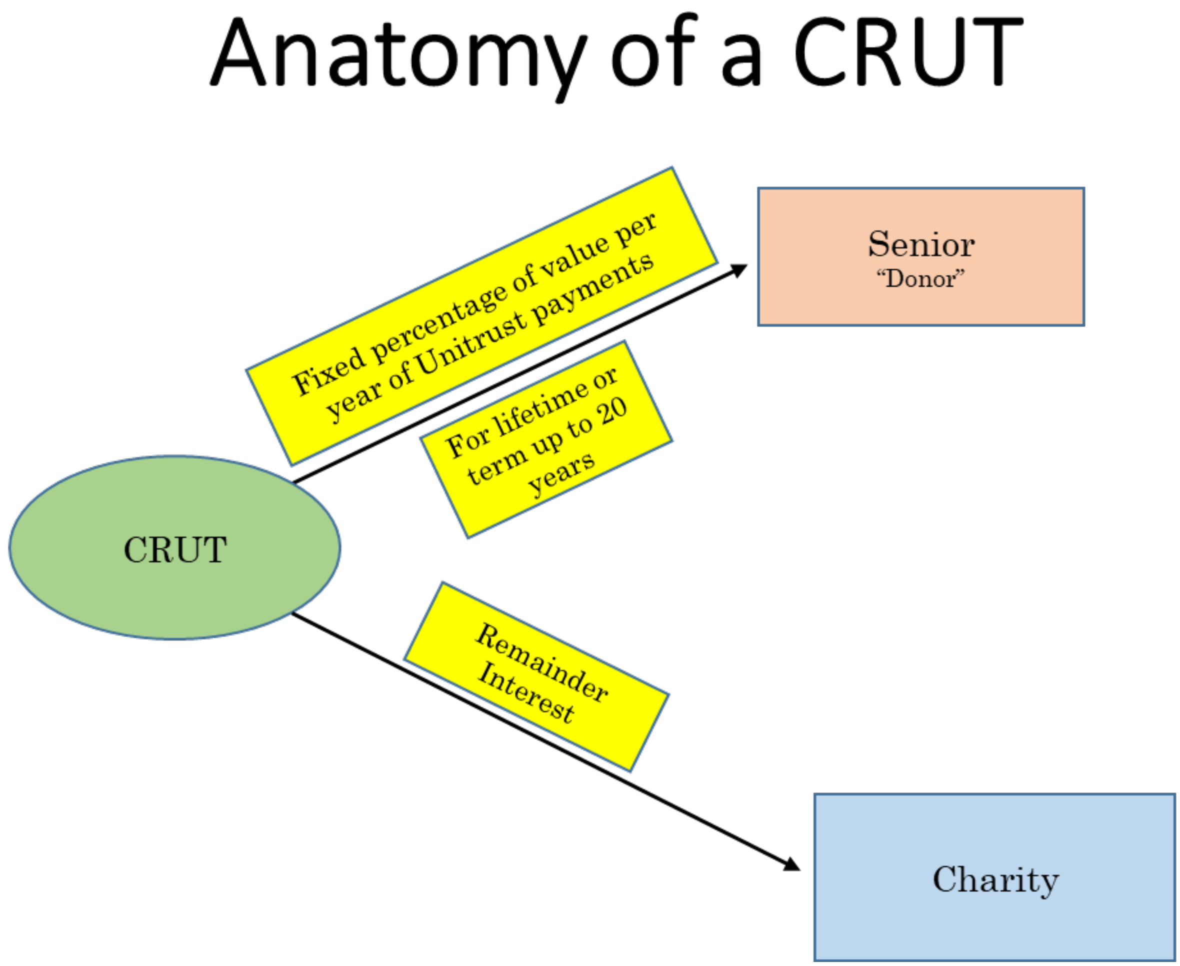
The grantor died and the IRS estate tax auditor asked the IRS Office of Chief Counsel for its opinion as to whether the 75% unitrust interest would qualify for one or both of the estate tax charitable or marital deductions.

The Chief Counsel opined that the 75% unitrust interest could not qualify for the marital deduction because the amount to be distributed to the spouse annually was within the discretion of the trustee and could not be ascertained as of the date of death.

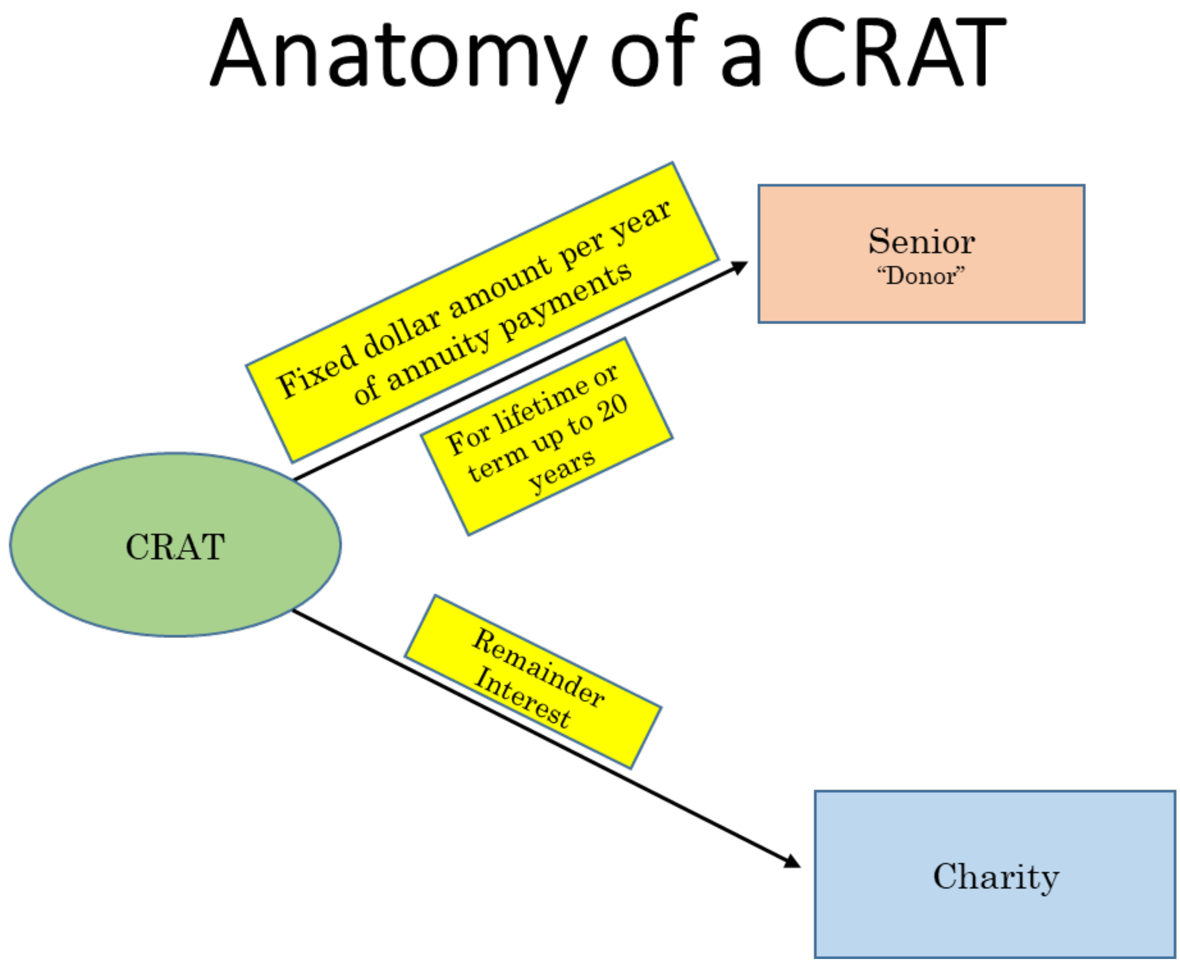
The CCA likewise concluded that the 75% unitrust interest could not qualify for the estate tax charitable deduction. Part of the language of the CCA that may be of interest is as follows:

> In this case, the terms of CRUT create two charitable interests: a discretionary interest in a portion of the unitrust amount and a remainder interest. Decedent's estate may claim an estate tax charitable deduction for the value of the remainder interest under § 2055(a), because CRUT is a charitable remainder unitrust described in § 664. *See* § 2055(e)(2)(A). However, Decedent's estate may not claim an estate tax charitable deduction under § 2055(a) for the value of any portion of the unitrust interest that may be distributed to Charity in the discretion of the trustee because Charity's interest is not in the form of a fixed unitrust amount to be distributed annually and no part of the unitrust interest is ascertainable or severable from Spouse's noncharitable interest. *See* § 2055(e)(2)(B) and § 20.2055-2(a).[160]

See Chart H of the EZ Learning Tool for Charitable Giving at the beginning of this book for a helpful comparison of a Charitable Remainder Trust, Charitable Gift Annuity, and a Pooled Income Fund.



[160] I.R.S., Chief Counsel Advice Memorandum 202233014 (Aug. 19, 2022).



G. Single-Parent Title-Holding Corporations

IRC § 501(c)(2) provides tax-exempt status for what it describes as follows:

> Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section. Rules similar to the rules of subparagraph (G) of paragraph (25) shall apply for purposes of this paragraph.

Therefore, a 501(c)(2) organization is one held solely for the benefit of a 501(c)(3) organization and organized and used for the sole purpose of holding title to property, collecting income from the property, and turning over the net income to another tax-exempt organization.

IRC § 501(c)(2) was enacted before charitable organizations were able to own LLCs that are disregarded for income tax purposes.

Treas. Reg. § 1.501(c)(2)-1 provides that an IRC § 501(c)(2) organization that is otherwise exempt from tax under section 501(a) is taxable upon any UBTI:[161]

> (a) . . . Since a corporation described in section 501(c)(2) cannot be exempt under section 501(a) if it engages in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business taxable income as defined in section 512 other than income which is treated as unrelated business taxable income solely because of the applicability of section 512(a)(3)(C); or debt financed income which is treated as unrelated business taxable income solely because of section 514; or certain interest, annuities, royalties, or rents which are treated as unrelated business taxable income solely because of section 512(b) (3)(B)(ii) or (13). Similarly, exempt status under section 501(c)(2) shall not be affected where certain rents from personal property leased with real property are treated as unrelated business taxable income under section 512(b)(3)(A)(ii) solely because such rents attributable to such personal property are more than incidental when compared to the total rents received or accrued under the lease, or under section 512(b)(3)(B)(i) solely because such rents attributable to such personal property exceed 50 percent of the total rents received or accrued under the lease.
>
> (b) A corporation described in section 501(c)(2) cannot accumulate income and retain its exemption, but it must turn over the entire amount of such income, less expenses, to an organization which is itself exempt from tax under section 501(a).

IRC § 501(c)(25)(G) provides that up to 10% of a 501(c)(2) organization's gross income can be from "the receipt of any otherwise disqualifying income which is incidentally derived from the holding of real property." Thus, a 501(c)(2) can receive up to 10% of its gross income from active business activities, which would not include passive leasing of property to arm's-length tenants. This may permit a building arrangement to generate money

[161] Note that a tax-exempt organization can lose its exempt status if the IRS determines that the organization's unrelated business activities are its "primary purpose." I.R.S. Tech. Adv. Mem. 9521004 (Feb. 16, 1995) ("[A tax exempt organization's] exemption is not jeopardized merely because it conducts an unrelated business as a substantial part of its total activities, as section 1.501(c)(3)-1(e)(1) of the regulations indicates. The key issues are the reason why the business is carried on and the organization's primary purpose. A purpose to raise funds to support the organization's exempt functions is a legitimate reason for an organization to conduct a business, although it would have to pay tax on any unrelated business taxable income derived from a business not otherwise substantially related to its performance of its exempt purposes. As long as the conduct of such business is not the organization's primary purpose, as determined by the facts and circumstances, the organization may conduct such business consistent with section 501(c)(3)."); Preston J. Quesenberry, *How Much Unrelated Business Activity Is Too Much?*, The Tax Advisor (June 1, 2021), https://www.thetaxadviser.com/issues/2021/jun/unrelated-business-activity-substantial-tax-exempt-organizations.html.

from parking, vending machines, and similar traditional landlord activities that would not be permitted if conducted under a 501(c)(3) organization.

Section 501(c)(2) organizations are strictly prohibited from engaging in any unrelated trade or business that is not permitted under the above de minimis rule but may nevertheless receive income from one or more of the following sources without losing its tax-exempt status.

Citing to Rev. Rul. 58-566,[162] PLR 200449034 (September 10, 2004) states that a corporation does not meet the requirements of 501(c)(2) if it has "broad powers and business purposes far beyond the scope necessary to a holding company."

Further, PLR 200449034 also ruled that an organization was not exempt under IRC § 501(c)(2) because it was not owned by a single exempt organization but rather by several individuals.

PLR 201338045 (April 9, 2009) states that because of the inability for a 501(c)(2) organization to engage in business other than holding title and collecting income, there is generally no UBTI other than UBTI under IRC § 514.

PLR 201338045 also states that income from rental offices to the general public does not preclude exemption if the 501(c)(2) organization does not render substantial services to the tenants other than normal maintenance of the building and grounds.

PLR 201338045 notes that neither the Internal Revenue Code nor the Treasury Regulations specify when the income should be turned over to the parent company but states that a 501(c)(2) organization should turn over the income "as soon as practicable, but at least annually."

Section 501(c)(2) organizations are further discussed at the end of the following section on State and Local Property Tax Implications.

1. <u>State, County, and Local Property Tax Implications of Holding Real Estate under Charitable Organizations; Liability Limitation; and Other Structuring</u>

Well-advised charitable organizations may hold real estate in entities separate from the operational activities of the charity in order to protect the real estate from potential liability. An example of this might be a church or synagogue that operates in a building that has significant value.

In order to protect the building from potential loss from liability from operations of the synagogue, a 501(c)(3) nonprofit corporation may own one nonprofit subsidiary LLC that is the operational synagogue and a second subsidiary that owns the property and building and allows the synagogue to operate there.

[162] 1958-2 C.B. 261.

Some jurisdictions will not give the charitable property tax exemption to a subsidiary of a 501(c)(3) organization unless a 501(c)(2) title holding entity is used.[163]

For example, in the Florida case of *Genesis Ministries, Inc. v. Brown*,[164] one not-for-profit corporation that operated a church cooperated with a separate not-for-profit corporation that owned the church property.

The Florida Ad Valorem Tax statute requires that to be exempt from property taxes the property must be both (1) owned by an exempt entity and (2) used exclusively for exempt purposes by such entity. Having one charity operate the church while another owns the building was not sufficient even when the two organizations appeared to be commonly controlled.

The First District Court of Appeal upheld the trial court's decision, citing the following case law and statutory law for the denial of the exemption for the years 2005 through 2012:

> "All property owned by an exempt entity and used exclusively for exempt purposes shall be totally exempt from ad valorem taxation." § 196.192(1), Fla. Stat. (2005). The law requires that the exempt entity both own *and* use the property. *Ocean Highway & Port Auth. v. Page*, 609 So.2d 84, 86 (Fla. 1st DCA 1992) ("[U]nder the plain language of section 196.192, an ad valorem tax exemption is only permitted when the property in question is *both owned and used* by the tax-exempt entity.") (emphasis in original); *see also Metropolitan Dade Cty. v. Bros. of Good Shepherd, Inc.*, 714 So.2d 573, 573 (Fla. 3d DCA 1998) (reversing final judgment, finding that "the property in question, although concededly used for exempt charitable purposes by an exempt entity, was not, as the statute requires, 'owned' by that entity"). It is not enough that an exempt entity owns the property and that the property is being used for exempt purposes. The exempt entity owner must also be the entity using the property for exempt purposes. *Ocean Highway*, 609 So.2d at 86.

Similarly, the Virginia Attorney General issued Advisory Opinion 18-27 on August 9, 2019, which indicated that the Virginia property tax exemption for a charitable organization that owns and operates its charity on real estate will not be exempt from property taxes because the single-member LLC owning the real estate is an entity separate from the operational charity that owns the LLC. Effective December 31, 2017, private colleges and universities that (1) have at least 500 or more students; (2) have more than 50% of their students in the United States; and (3)

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[163] Special thanks to Michael Lehmann of the law firm Dechert LLP for providing us with this information. Michael has indicated that all five boroughs of New York City will disregard an LLC that is wholly owned by a 501(c)(3) organization to allow charitable property tax status, but that at last view Philadelphia, San Francisco and Chicago do not. A § 509(a)(3) organization may hold real estate for a Public Charity, but Philadelphia would not permit this for a Private Foundation.

[164] 250 So. 3d 865 (Fla. 1st Dist. Ct. App. 2018).

have assets separate from those directly used to carry out exempt purposes with an aggregate fair market value of at least $500,000 per student are required to pay a 1.4% excise tax on such "net investment income." The tax does not apply to public universities or to monies spent to carry out educational purposes.

2. State and Local Taxes for 501(c)(2) Land Holding Companies

501(c)(2) Land Holding Companies, also known as Single-Parent Title-Holding Corporations, are discussed above and have generally not fared well with state and local tax exemption planning.

In *Deutsches Land, Inc. v. City of Glendale*,[165] a case before the Supreme Court of Wisconsin in 1998, the court acknowledged that the petitioner, Deutsches Land, was a 501(c)(2) organization. Despite this, the court affirmed the decision of the appellate court, which denied exemptions from property taxes. The opinion states that, even though the petitioner was a 501(c)(2) organization, it failed to offer sufficient evidence to support its requested exemptions, thus showing that merely being a 501(c)(2) organization is not enough to be exempt from property taxes in Wisconsin.

In *Chagrin Realty, Inc. v. Testa*,[166] a case before the Supreme Court of Ohio in 2018, the Court explicitly stated that an organization with 501(c)(2) status does not qualify as a charitable institution under Ohio law because the federal law is less restrictive. Further, the Court noted that the petitioner's reliance on 501(c)(2) "conflates Ohio's property-tax exemption with inapplicable federal standards for tax-exempt charities" and that they have specifically rejected the idea of "substitut[ing] [the] more lenient federal-law standards for the well-developed Ohio law of charitable use."[167]

In *Most Worshipful Grand Lodge of Ancient Free & Accepted Masons v. Board of County Comm'rs*,[168] a case decided by the Supreme Court of Kansas in 1996, the court quoted the Kansas Constitution, which provides that property leased to organizations that are tax exempt under 501(c)(2), (3), (4), (8), and (10) is subject to property tax base amounting to 12% of its fair market value.

3. Reassessment Warning!

Some states, counties, or municipalities have property tax rules that prevent the taxing authorities from raising property taxes to reflect the fair market value of real estate, unless certain transfers occur. For example, Florida Statutes §§ 193.1554 and 193.1555 generally provide that real estate taxes on non-homestead commercial and residential real estate cannot increase by more than 10% per year. Transferring such property to an LLC or charitable organization may trigger

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[165] 225 Wis. 2d 70 (Wisconsin 1999).
[166] 154 Ohio St. 3d 352 (Ohio 2018).
[167] *Id.* at 358 (quoting *Dialysis Clinic, Inc. v. Levin*, 127 Ohio St. 3d 215, at ¶ 26).
[168] *Most Worshipful Grand Lodge of Ancient Free & Accepted Masons v. Bd. of Cty. Comm'rs*, 259 Kan. 510 (Kansas 1996).

loss of the cap and therefore cause higher property taxes for the remaining years that the property is owned by a recipient.

H. Charitable Lead Annuity Trusts

In addition to the disposition for charity, a philanthropic individual could provide for some assets to pass on death to a "zeroed-out Charitable Lead Annuity Trust" that would qualify for the estate tax charitable deduction for the full value of assets passing to it. The individual could additionally provide that, after a series of payments to a selected charity or charities, any remaining assets would pass to the same person, people, or entity who have the option to purchase other estate or trust assets for the Administrative Note.

An example, as of July 2022, of this would be a Charitable Lead Annuity Trust that would pay $709,990.27 annually to charity for 20 years. Assuming that the assets grow at a rate above 3.6%, any remaining assets will pass to the trust or individuals who owe the Administrative Note. If the assets have a 7% rate of return, then there will be $9,590,444 remaining at the end of the term.

A CLAT must generally be funded with non-business and non-active real estate or other assets because of the unrelated business income and other Private Foundation rules that a CLAT is subject to. However, a CLAT may be funded with a limited partnership or non-voting LLC interest that may be valued on a discounted basis.

For example, consider a CLAT that is funded with $1 million worth of discounted non-voting LLC interests held under a family LLC that is valued at a 25% discount, with assets that will grow at 6% per year. Assuming that the LLC will make annual distributions sufficient to enable the CLAT to make its charitable payments, the CLAT's share of the underlying LLC's assets at the end of year 20 will be worth $1,248,330. There will be no income tax on dividends, interest, capital gains, or other components of income under a typical CLAT/LLC scenario because distributions to charity carry out any distributable net income under a properly structured testamentary CLAT.

Philanthropic families who want to take advantage of the time value of money may want to get the CLAT started well before the death of a philanthropist, so that the note can be prepaid earlier than 20 years after the formation of a post-death testamentary CLAT. The above techniques are explained in Private Letter Rulings 200404009, 200328030, 199908002, and 201834011, which permitted an Administrative Note to be used to purchase assets passing from a Q-TIP Trust on the death of the surviving spouse, even though the Administrative Note Regulations only refer to an estate. This demonstrates that the IRS, at least presently, takes a somewhat liberal view of this aspect of this Treasury Regulation.

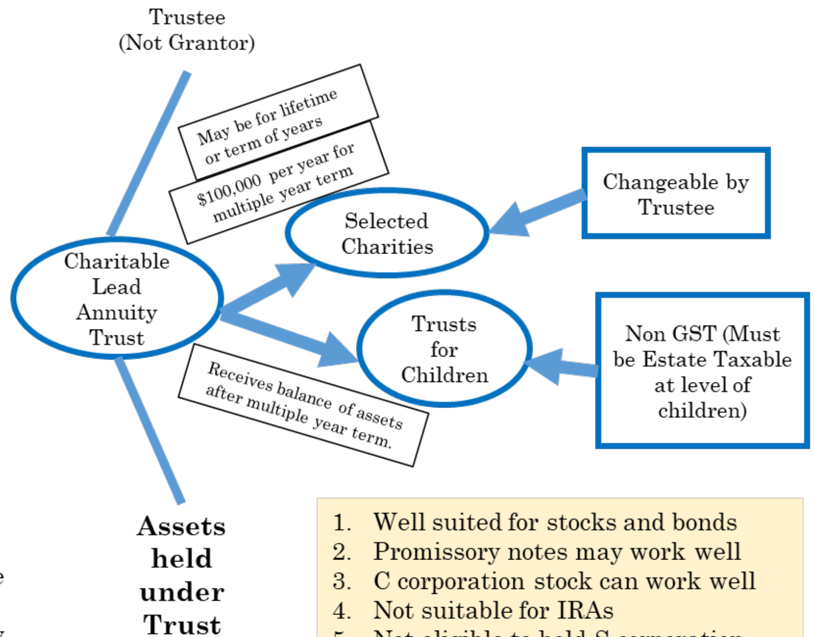
Lifetime Charitable Lead Annuity Trust

Grantor CLAT

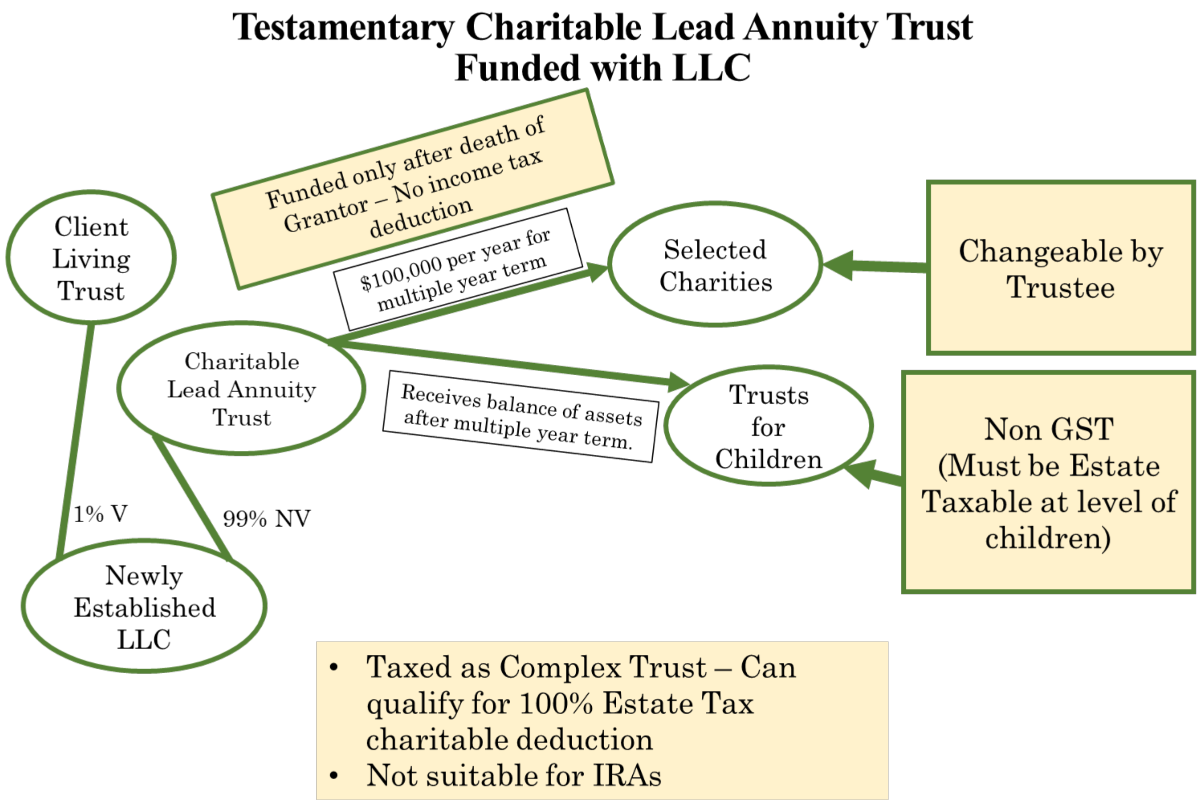
- Grantor gets charitable deduction upon funding
- Grantor pays income tax on income – No further deduction for what goes to charity
- Charitable deduction recaptured if Grantor dies during annuity term

Non Grantor CLAT

- No charitable income tax deduction upon funding
- Income not taxable to the Grantor
- Trust is taxed as complex – Payments to charity carry out distributable net income
- Transfer of appreciated assets from CLAT to charity triggers income tax – Offset by value of what goes to charity



1. Well suited for stocks and bonds
2. Promissory notes may work well
3. C corporation stock can work well
4. Not suitable for IRAs
5. Not eligible to hold S corporation interests
6. Other limitations apply



I. Pooled Income Funds

A Pooled Income Fund is a legal entity established by and for the benefit of a Public Charity that receives donations of money or assets from donors and pays the donors pro rata portions of the net income from the fund for the lifetime of a designated person or persons.

While Charitable Remainder Trust donors can have control, flexibility to change the beneficiary and investments, and may serve as trustee of the Charitable Remainder Trust, those transferring smaller amounts or who are willing to allow a charitable organization to have control and irrevocable rights to benefit may prefer to participate in Pooled Income Funds in addition to or in lieu of Charitable Remainder Trusts.

The donation to a Pooled Income Fund will qualify for the federal gift tax charitable deduction to the extent of the value of the remainder interest, or the federal estate tax charitable deduction if a disposition to a Pooled Income Fund occurs upon death, based upon the value of the remainder interest as determined under the IRS regulations. The valuation of the remainder interest if there is a single beneficiary is based upon Table S:

- Table S in Treasury Regulation § 1.642(c)-6(e)(6) for gifts made after April 30, 2009,

- Table S in Treasury Regulation § 1.642(c)-6A(e)(5) for gifts made before May 1, 1999., or

- Table S in Treasury Regulation § 1.642(c)-6A(f)(6) for gifts made after April 30, 1999, and before May 1, 2009.

Table S is also available to download as an Excel spreadsheet from the IRS website at https://www.irs.gov/retirement-plans/actuarial-tables.

If there is more than one income beneficiary, the valuation is based upon Publication 1457, *Actuarial Valuations Version 3A*.

This can be complicated because the definition of the word "income" can vary from one Pooled Income Fund to another. Pooled Income Fund income is "determined under the terms of the governing instrument and applicable local law,"[169] "except that income generally may not include any long-term capital gains."[170]

Donors receive an income tax charitable deduction based upon the amount of money or value of assets transferred to the Pooled Income Fund, subject to the annual limitations on deductions for gifts to public charities and the limitations that apply if tangible personal property is donated for a use other than the eventual use by the charity itself.

Gift	Income Tax Charitable Deduction
Appreciated property held as capital gain property for more than one year	Fair market value of remainder interest, subject to the annual limitation of 30% of donor's contribution base to public charities
Cash	Limited to 60% of donor's contribution base to public charities

On the death of a beneficiary, the portion of the Pooled Income Fund that the beneficiary was entitled to will pass to the applicable charity.

The Pooled Income Fund assets are valued each time a donation is made, and each new donor is assigned a percentage of the entire Pooled Income Fund that only changes vis-à-vis other donors when new donations are made.

A Pooled Income Fund is taxed as a complex trust and is subject to the 3.8% § 411 Medicare tax on income exceeding the complex trust limit, which is $13,450 for 2022.

As with any complex trust that pays out all of its income, the Pooled Income Fund should only pay federal income taxes on short term capital gains. However, unlike complex trusts, Pooled Income Funds and their donors will not be subject to capital gains taxes whatsoever if certain requirements are met. These requirements include that a depreciation reserve fund is established and that the trustee must not have "the power, whether or not exercised, to satisfy the income beneficiaries' right to income by the payment of either:"[171]

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[169] I.R.C. § 643(b).
[170] Treas. Reg. § 1.642(c)-5(a)(5)(i) (as amended in 2004).
[171] Treas. Reg. § 1.642(c)-2(c) (as amended in 2004).

- "[A]n amount equal to a fixed percentage of the fair market value of the fund's assets (whether determined annually or averaged on a multiple year basis);"[172] or

- "[A]ny amount that takes into account unrealized appreciation in the value of the funds assets."[173]

Revenue Ruling 90-103, 1990-2 C.B. 159, held that a pooled income fund must be required to establish a depreciation reserve fund. The Revenue Ruling provides the following explanation with respect to this requirement:

> [T]he regulations assume that there will be a reasonable relationship between the value of the property upon which the charitable deduction is based in the year of the contribution and the value of the property that is to be received by the charitable remainderman in a later year.
>
> The only way to assure such a reasonable relationship is to establish a reserve to protect the value of the remainder interest. A depreciation reserve is designed "to protect the principal of the trust against loss due to the gradual shrinkage in value of the [depreciable property] . . . caused by obsolescence, wear and tear, and depreciation in value, which may occur even if ordinary repairs were constantly being made. . . ." G. Bogert, Trusts & Trustees, Sec. 600 (Rev. 2d ed. 1980). In the absence of a reserve for depreciation, there is no certainty that the charity will receive anything of value on the termination of the noncharitable interests. The allowance of a deduction in respect of a contribution to a pooled income fund implies the need for a depreciation reserve to preserve the value of the fund's assets. Similarly, the method of valuing the deduction provided by section 1.642(c)-6 of the regulations assumes that the value of the properties will be preserved. . . .
>
> [T]o ensure that the value of the remainder interest is preserved for the charitable remainderman, the governing instrument of a pooled income fund must provide for the creation of a depreciation reserve pursuant to GAAP, if the trustee either has the authority to accept or invest in, or is not specifically prohibited from accepting or investing in, depreciable property.[174]

A charity can establish multiple Pooled Income Funds so that various categories of donors can participate in funds of their choosing.

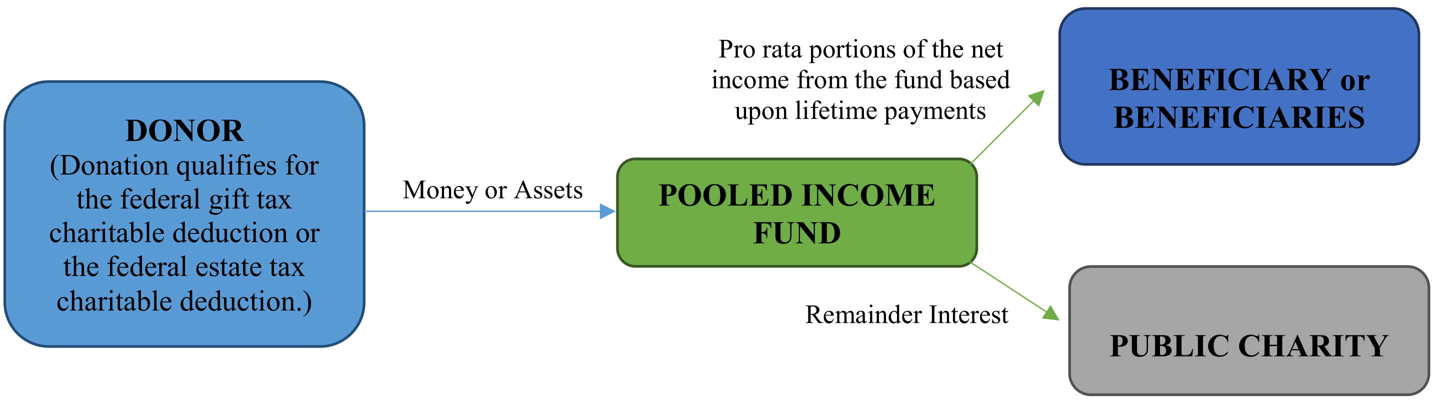
The Pooled Income Fund can provide that a certain portion of its income can be paid to the applicable charity. If necessary, the fund can pay its income out within 65 days after the end of

[172] Treas. Reg. § 1.642(c)-2(c) (as amended in 2004).
[173] Treas. Reg. § 1.642(c)-2(c) (as amended in 2004).
[174] Citations omitted.

each calendar year and consider the amount paid to have been transferred to the donor/beneficiaries in the previous calendar year.

Pooled Income Funds are not permitted to invest in tax-free bonds or any other tax-free investments but are permitted to allocate depreciation write-offs to the donor income recipients.

A Pooled Income Fund donor must receive payments for life or may designate a life income beneficiary or multiple joint and survivor beneficiaries to receive distributions. Further, the donor may retain the right to terminate an income beneficiary's right to income after the death of the donor by designating such termination under the donor's last will and testament.



J. <u>Charitable Annuities</u>

An annuity is a promise by one party to make payments to another over a measuring period based on an up-front transfer of assets to the first party.

Remarkably, annuities actually date back thousands of years. Early examples of annuities are as follows:[175]

- An annuity contract from 363 BC provided guaranteed maintenance to an Egyptian wife.
- The Lex Falcidia, an ancient Roman law, addressed annuities.
- A Roman mortality table used to value annuities was created as early as the third century.
- Yale gave American artist John Trumbull an annuity in 1831 in exchange for over 50 of his paintings.

A Charitable Annuity is an agreement that is entered into between a donor and a charity whereby the charity accepts cash or other property in exchange for an obligation to pay the donor

[175] Ronald A. Brown, *Risk And Reward: A History Of Charitable Gift Annuities*, HistPhil (April 25, 2018), https://histphil.org/2018/04/25/risk-and-reward-a-history-charitable-gift-annuities/.

or a designated individual an annuity payment, which will normally be equal annual payments for the lifetime of the annuitant.

The amount to be paid each year will typically be based upon gift annuity suggested maximum rate schedules that are issued by the American Council of Gift Annuities (ACGA). The schedules are generally based upon the payments being equal to one half of what a competitive fixed payment life annuity would pay if issued by a commercial annuity company. The American Council of Gift Annuities designs the annuity rates to give the charity approximately half of the contributed funds.[176]

As a result of this, the donor can receive a charitable income tax deduction based upon approximately one half (typically between 40% and 60%) of the value of the assets or cash amount paid to the charity in exchange for the annuity payment right. The charitable deduction is equal to the difference between the value of assets or cash amount transferred and the value of the annuity payments.

When appreciated assets are transferred in exchange for the annuity right, the donor will not pay income tax at the time of the transfer and will instead pay tax at capital gains rates on the capital gain element of the assets transferred over the life expectancy of the donor, as determined under the IRS mortality tables at the time of the transfer.

In addition, each payment received under the annuity will have an element of ordinary income to take into account that the annuity is expected to pay more than the amount invested for it. IRC § 72 provides that annuity payments are includable in gross income to the extent that the payments exceed "investment in the contract." IRC § 72 defines "investment in the contract" using the following formula:

"[T]he aggregate amount of premiums or other consideration paid for the contract"

\- "[T]he aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income"

= "Investment in the contract"

1. <u>Three Types of Charitable Gift Annuity Agreements</u>

The American Council on Gift Annuities provides the following descriptions of the three types of charitable gift annuities, the Immediate Gift Annuity, the Deferred Gift Annuity, and the Flexible Annuity:

> **Immediate Gift Annuity**
>
> With an Immediate Gift Annuity, the annuitant(s) start(s) receiving payments at the end (or the beginning) of the payment period immediately following the contribution. Payments can be made

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176 *Current Gift Annuity Rates*, American Council on Gift Annuities, https://www.acga-web.org/current-gift-annuity-rates#SingleLife (last visited Sept. 28, 2022).

monthly, quarterly, semiannually, or annually. The most common arrangement is quarterly payments at the end of the quarter. The end of a period can be any day of the month, but is typically the first day of a month, the last day of a month, or the anniversary date of the gift. The first payment is customarily prorated from the date of the contribution to the end of the first period and thus is smaller than the subsequent payments. It is, however, possible to stipulate that the first payment be for the full amount. All these factors have some effect on the amount of the charitable deduction.

The annual annuity is determined by multiplying the amount contributed by the annuity rate. The amount contributed is the fair market value on the gift date, NOT the net proceeds of sale if a CGA is funded with appreciated assets.

Deferred Gift Annuity

With a Deferred Payment Gift Annuity (DPGA), the annuitant(s) start(s) receiving payments on a date chosen by the donor at the time of the contribution that must be more than one year after the date of the contribution. As with immediate gift annuities, payments can be made monthly, quarterly, semiannually or annually.

Flexible Annuity

A Flexible (Deferred Payment) Gift Annuity means that the donor does NOT have to choose the payment starting date at the time of the contribution. Instead, the donor agrees to a range of possible payment start dates from which the annuitant can later choose. For example, the annuitant (who may or may not be the donor) may choose from among these payment start dates based on their retirement date or other considerations. The older the annuitant(s) when the payments start, the larger the payments will be.

This concept provides some of the flexibility offered by commercial annuities sold by insurance companies. The charity offers a schedule of payouts with differing fixed payment amounts and differing starting dates. The later the starting date in the schedule, the higher the annuity amount the charity agrees to pay. The schedule of possible payment start dates and their associated annuity amounts is established at the time of the contribution as part of the gift annuity agreement. Each annuitant must determine on an annual basis whether they wish the annuity payments to start that year.

Generally, planned giving tax calculation software does a good job in explaining these various types of annuity gift vehicles and some of them will even craft the gift annuity agreement that should meet the regulatory requirements of the states involved with that particular type of annuity gift.[177]

2. A Hypothetical by Professor Jerry Hesch

Senior, a Florida resident, age 70, intends to sell an appreciated asset for $10,000,000. Senior's cost basis is $2,000,000. He has a 15.5-year life expectancy. If the asset is sold for cash, Senior will report an $8,000,000 capital gain, taxable at 23.8%, pay $1,904,000 Federal income tax on the capital gain, and net $8,096,000 after taxes. If Senior invests the after-tax amount at 6.299%, Senior's annual income will be $510,000, and all of it will be taxable. If Senior lives in New York City, the combined income tax rate on a capital gain can be as high as 32% and Senior would net less after taxes.

The § 7520 rate for January 2021 was 0.6%. Senior sells the appreciated asset to a charity for an annual $510,000 annuity for life. Senior receives an immediate $3,126,883 charitable income tax deduction, saving $1,327,768 in income taxes. As a part-sale, part-gift, Senior has in effect sold $6,873,117 of the asset and gifted $3,126,883 of the asset. Basis is allocated between the gift and sale portion under Section 1011(b). See Treas. Reg. Section 1.1011-2 for examples. 68.73117% x $2,000,000 = $1,374,623 of basis allocated to the sale portion. With a sale for $6,873,117, Senior reports a $5,498,494 capital gain at a rate of $354,741 a year over the next 15.5 years upon the receipt of each $510,000 annuity payment.

Each year for the next 15.5 years Senior treats the $510,000 annual payment as:

- $88,448.48 tax-free basis
- $354,741.52 capital gain
- $66,810 annuity income (ordinary income, *i.e.* interest on the deferred payments).

After 15.5 years, all basis has been used so that all further payments are reported as $580,000 of annuity income.

An annual $510,000 annuity is the practical equivalent of a 6.299% rate of return on the after-tax $8,096,000 Senior would net if he paid the tax on the $8,000,000 capital gain and invested the $8,096,000 after-tax amount.

So, Senior is receiving the practical equivalent of a guaranteed 6.299% rate of return. But, for the next 15.5 years, $866,810 of the annuity is a tax-free return of basis, so that only the excess is taxable.

Senior has an immediate benefit from the $3,126,883 charitable income tax deduction that can save Senior $1,275,768 in Federal income taxes in year 1.

Senior is far better off with the charitable gift annuity.

[177] *About Gift Annuities*, American Council on Gift Annuities (Nov. 24, 2020), https://www.acga-web.org/about-gift-annuities.

If Senior lives well into her 90s, she has the financial security that the annuity will continue for as long as she lives.

If Senior did no planning, sold the appreciated asset, and invested the after-tax $8,096,000, Senior will still have this amount to pass on to her descendants. With the annuity, there is no amount passing on to her descendants. But, the $1,327,768 of income tax savings from the $3,126,883 charitable income tax deduction, and what it grows to, will replace a significant portion of the $3,126,833 gifted to charity.

Remember that Senior age 70 is officially expected to live for 15.5 years for calculation purposes. Realistically, Senior will live another 20 or more years. So the value of the retained annuity is undervalued. Using 20 years, Senior lives to age 90, and a 0.6% discount rate, the value of the retained annuity is $9,584,726.

3. <u>Charitable Planning with Annuities</u>

Many individuals own variable annuity contracts that will spray out ordinary income after death.

In general, an annuity contract can be payable to a surviving spouse, and the surviving spouse can "roll the annuity" into his or her own variable annuity and defer taking distributions until 5 years after death, unless the surviving spouse remarries and leaves the annuity to a subsequent spouse.

Distributions from a variable annuity generally carry out ordinary income to the extent of the excess of the value of the annuity over the income tax basis of the annuity, which is known as the "Investment in the Contract."

One planning technique would be to have the annuity payable by beneficiary designation to a charitable remainder unitrust or a 501(c)(3) organization to the extent of income within the annuity contract, with the remaining value to pass to or in trust for the benefit of family members.

For example, Jose has a variable annuity worth $500,000 as the result of having made $300,000 in premium payments.

On his death the first $200,000 of distributions will go to the 501(c)(3) family foundation that he established or to a donor advised fund, with the remainder passing to a trust for his children. This should avoid all income tax from the annuity.

K. <u>Verifying Tax-Exempt Status and Public Charity Qualification</u>

Donors and their advisors can confirm the 501(c)(3) status of a donee organization by checking one of the five IRS-sponsored databases on what is known as Select Check. Select Check is available at https://apps.irs.gov/app/eos/. The IRS website provides the following explanations of the five databases:

[1] Form 990-Series Returns

You can review the list of organizations that have filed forms in the Form 990 Series:

- Form 990
- Form 990–EZ
- Form 990–PF (501(c)(3) Private Foundations)
- Form 990–T (990–T returns for 501(c)(3) organizations only) . . .

[2] Form 990–N (e-Postcard)

Form 990-N (e-Postcard) is an annual electronic notice most small tax-exempt organizations (annual gross receipts normally $50,000 or less) are eligible to file instead of Form 990 or Form 990-EZ. . . .

[3] Pub. 78 Data

Lists of organizations that can receive tax-deductible contributions.

- Users may rely on this list in determining deductibility of their contributions.
- If an organization uses a "doing business as" (DBA) name, that name will not be listed in the Pub. 78 Data. Only the organization's official name submitted to the IRS is included in the data set.
- Some donees (i.e., churches, group ruling subordinates, and governmental units) eligible to receive tax-deductible charitable contributions may not be listed in Pub. 78 Data. . . .

[4] Auto-Revocation List

By law, tax-exempt status is automatically revoked if an organization does not file the required Form 990-series returns or notices yearly for 3 consecutive years. The automatic revocation date is historical. It is the organization's effective date of automatic revocation (the date for the filing of the third annual Return or notice), but doesn't necessarily reflect its current tax-exempt status.

An organization may apply for reinstatement of its tax-exempt status after the automatic revocation date had posted. IRS will recognize the reinstatement of the organization's tax-exempt status if the application is approved. You can find out if the exemption status has been reinstated by reviewing the Pub. 78 Data (for 501(c)(3) organizations) or reviewing its determination letter, which would

> show an effective date on or after the automatic revocation date, with the online tool or the bulk data download files. You may also review the EO BMF Extract to check the organization's current exempt status.
>
> **Revocation date of certain organizations**
>
> Organizations that do not file a required annual information return or notice for three consecutive years automatically lose their tax-exempt status by operation of law. An automatic revocation is effective on the original filing due date of the third annual return or notice (the "Revocation Date"). Due to the COVID-19 emergency, this year the IRS extended the filing dates for these returns and notices due from April 1 through July 14 to July 15, 2020. Organizations eligible for this relief that failed to file for the two previous years and did not file by July 15 have automatically lost their tax-exempt status. Due to systemic limitations, these organizations appear on the auto-revocation list showing a Revocation Date between April 1 and July 14, 2020. However, the Revocation Date for these organizations is July 15, 2020. . . .
>
> **[5] Determination Letters dated on or after January 1, 2014**
>
> IRS issues a determination letter recognizing an organization as tax-exempt under the sub-section for which it applied. An organization must apply and pay a user fee to receive a determination letter.

The database includes copies of the Form 990s filed by tax-exempt organizations and copies of favorable determination letters issued by the IRS to recognize tax-exempt status.

Contributors can rely upon the information provided in the Pub. 78 Data database for deductibility purposes unless or until there is a public announcement, which will normally be in the Internal Revenue Bulletin indicating that the organization no longer qualifies as a 501(c)(3) entity.

Similar rules apply with respect to the determination that a 501(c)(3) organization is characterized as a public charity.

L. How Charitable Entity Types Interact

Type of Charitable Donation/Strategy	Private Foundation	Public Charity	Donor Advised Fund

Charitable Remainder Trust	Can be a beneficiary, but charitable deduction subject to Private Foundation AGI limitations and Grantor should not control the foundation.	Yes, up to 50% of AGI deduction, 30% for capital gain property.	Same as listing a Public Charity as the charitable beneficiary, but donor should not advise the DAF after termination of the Charitable Remainder Trust.
Qualified Charitable Donation	QCDs cannot be made to Private Foundations.	Up to $100,000 can be donated without the taxpayer paying any tax on the donation.	QCDs cannot be made to a Donor Advised Fund.
IRA Beneficiary Designation	Can be left to a Private Foundation on death for an estate tax charitable deduction.	Can be left to Public Charity on death of an estate tax charitable deduction.	Can be paid to Donor Advised Fund on death for estate tax charitable deduction.
Charitable Gift Annuity	Not allowed.	Yes. A deduction is allowed for the actuarial amount projected to go to charity.	No allowed.
Charitable Lead Annuity Trust	Allowed, but subject to 30% of AGI for cash and 20% for capital gain assets. Grantor cannot control Private Foundation.	Allowed, but deduction is subject to various AGI restrictions because donation is considered to be "for the use of the charity." AGI limited to 20% to 50% depending on assets contributed.	Allowed. Same as benefiting a Public Charity, but donor should not control the Donor Advised Fund.

CHAPTER 3: STRATEGIES AND IMPORTANT DEVELOPMENTS

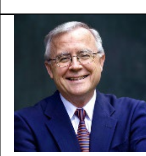
The following may be of interest to planners who wish to offer not so well-known or often-used strategies.

A. Strategies

Outright Gifts		
For taxpayers who itemize deductions for tax year 2021: When itemized deductions exceed $12,550/single taxpayers, $18,800 for heads of households and $25,100 for married taxpayers.	You have automatic deduction for these amounts, unless the sum of property taxes up to $10,000, plus medical expenses exceeding 7.5% of adjusted gross income, plus interest expense allowable on home mortgage, plus charitable deductions exceed these thresholds. Strategy is every other year or every third year, you pay a lot to get over the threshold to have the deduction – called bunching your deductions.	You can pay the excess money to a charity or to a donor advised fund and then later it is given to a charity.
If you are over 70-1/2: You can do a qualified IRA transfer.	You can transfer up to $100,000 a year directly from your IRA to charity.	For 2020 and 2021, it is unlimited for anyone over 59-1/2.
Collectibles: You can give collectibles like cars, jewelry, and artwork.	Deduction can be based on fair market value, if the charity uses the item received as part of its mission.	**EXAMPLE:** Artwork displayed in a museum or university hallway.
Depreciable buildings:	Can be given to a Private Operation Foundation or Public Charity for fair market value of building without depreciation recapture – building may be subject to old debt if qualifies under the "old debt exception" to the Unrelated Business Taxable Income ("UBTI") rules.	Donor can continue to manage the building and remit rent income to charity while getting a deduction for the total fair market value of the building.

Outright Gifts		
Part Ownership of Business:	Donor retains control of business and gives part ownership to charity. Donor receives income tax deduction for value, and charity receives part of profits.	*See* LISI Charitable Planning Newsletter #280 - Alan Gassman, John Beck & Michael Lehmann: Donor Controlled Charitable Business System (March 11, 2019) at http://www.leimbergservices.com.
Have a Party for Charity:	Write off the cost, or have the charity reimburse you for the cost. Redecorate your house while you are at it.	
Ask Clients Who Dispute Your Fees to Pay the Amount in Question to a Worthy Charity.		
No More Free Consultations – Ask that a Donation Go to Saint Petersburg College if the Client Does Not Hire You.		
Move a Historical House to a Museum or Orphanage:	Deduct the full value of the antique home.	

Outright Gifts		
For Donors Who Would Like to Go Above the Maximum Adjusted Gross Income Donation Amounts:	2021 – Create income by withdrawing from IRA or otherwise and give to charity under 100% of adjusted gross income/cash rule that expires December 31, 2021. Make interest-free loans to the charity. Provide rental space without charging rent to a charity. Pay for advertising and sponsorship rights. Subsidize contributions made by friends and family members who can donate and receive tax deductions.	
Buy Your Loved One New Jewelry and Donate the Old Jewelry at Fair Market Value:	The fair market value of used jewelry may substantially exceed what it would actually sell for – valuation of jewelry can be based upon what the taxpayer would normally pay.	Must be used / displayed by the charity to deduct fair market value.
Make Gifts from Low Income Bracket Taxpayers to High Bracket Taxpayers to Enable Them to Make a Donation:	Example: Grandma is in the 15% bracket and wants to give $20,000 to her church. Her son is in the highest bracket and makes a $20,000 donation. Grandma may choose to give her son a $20,000 disposition under her estate plan.	

Legacies on Death – Whether Directly on Death or Contingent Upon Others Not Surviving		
Leave Cash in Your Will or Trust:	No income tax deduction, but there will be an estate tax deduction.	
Provide that Income from Your Estate or Trust Will Be Paid to the Charity:	This carries out distributable net income to save income tax for Remainder Beneficiaries. Must have Section 642(c) language in original Trust Agreement	 Professor Dennis ("DNI") Calfee

Legacies on Death – Whether Directly on Death or Contingent Upon Others Not Surviving		
Give IRD (Income with Respect to a Decedent) Assets: **Note-**This means give your IRA to charity	No income tax will be paid on IRA proceeds going directly to charity or passing through properly drafted trust to charity.	Distribution to charity will qualify for estate tax charitable deduction
Life Insurance:	Can deduct premiums if charity owns the policy.	
Use Charitable Lead Annuity Trusts ("CLATs") to Zero Out Estate Tax:	Jacqueline Kennedy Onassis – **EXAMPLE:** 15 annual payments to charity with remainder to family – zero estate tax and family can expect a significant inheritance after term of years for charity.	Can arrange as a disclaimer choice – I give the rest to my daughter, but anything she disclaims goes to CLAT for charity.
Charitable Remainder Trusts:	Pay my family annually for 20 years the maximum percentage that is allowed each year and can apply without incurring estate tax. Make annual payments for life of my son, and remainder to charity thereafter.	Remainder to charity.

Hybrid Donations – Promise During Lifetime for Gift on Death – Deduct the Value of the Tree – Keep the Fruit		
Give a Remainder Interest in a Personal Residence – Retain Life Estate:	Good for elderly donor who may donate life estate later.	Will not detrimentally impact Medicaid planning?
Give a Remainder Interest in the Family Farm:	This works the same as giving the Remainder Interest in your home.	
Charitable Remainder Trusts: (CRATs and CRUTs are defined below)	Get tax deduction and tax deferred capital gains by giving away the tree and receive the fruit for a period of time – get tax deduction upon formation.	Some charities will form the CRT and serve as Trustee at no charge, if certain requirements are met.
Charitable Remainder Annuity Trusts ("CRATs"):	Donor will receive a fixed annual payment, notwithstanding the performance of the Trust until assets run out. May receive all back.	

Hybrid Donations – Promise During Lifetime for Gift on Death – Deduct the Value of the Tree – Keep the Fruit		
Charitable Remainder Unitrusts ("CRUTs"):	Donor will receive a percentage of value of Trust each year and share in increasing values – presently approximately just over 11% per year of value for 20 years if not using a life payment. Upon inception, the table value for remainder to charity need not exceed 10% - Allows for deferral of capital gains.	Ideal for holding an asset that is about to be sold. Using FLIP NIMCRUT can allow for up to 14 years deferral of all income tax from a large transaction like the sale of a business or highly appreciated stock. May work best economically.
Charitable Lead Annuity Trust ("CLATs"):	Charity gets fixed payments for a term of years – remainder can pass estate and gift tax-free to next generation after term of payments.	Most often arranged so that Grantor gets a 100% charitable income tax deduction, even though much passes estate tax-free to family after term of years payments to charity.
Charitable Life Annuity for Donor or Family for Lifetime Payments that May Start in the Future.	Part Gift, Part Purchase – can give appreciated assets while deferring taxes on "sale."	First payments during life expectancy are part capital gains, part ordinary income, and part return of capital. All ordinary income after life expectancy.
Pooled Income Funds.	All ordinary income when received.	

Liquidity Event Planning		
Sell Asset or Company and Then Give Cash from Sale to Charity:	Least effective.	**EXAMPLE:** Sell \$1,000,000 asset with zero basis and donate \$200,000 to charity. Pay capital gains tax on \$800,000. 23.8% of \$800,000 is \$190,400. \$800,000 - \$190,400 = \$609,600.

Liquidity Event Planning		
Gift Part Ownership of What Will Be Sold to Charity Immediately Before There is a Legally Binding Obligation:	The tax deduction for the value of what is given will eliminate income tax on an equal portion sold.	**EXAMPLE:** Donate 20% of $1,000,000 company to charity and sell 80% for $800,000. Tax based on $800,000 - $200,000 charitable deduction = $600,000. 23.8% of $600,000 = $142,800. $800,000 - $657,200. **NET RESULT IS MUCH BETTER FOR THIS ONE THAN FIRST EXAMPLE ABOVE.**
Defer All Income Tax from Sale for Approximately 14-15 Years Using Charitable Remainder Unitrust ("CRUT"):		In Example above, donate 20% to charity before sale, and have 80% be sold by Charitable Remainder Unitrust – Pay income taxes ratably, based upon 11% of value withdrawals over 20 years, or defer any distributions for up to 14-15 years using FLIP NIMCRUT.

To Avoid Estate Tax		
Place Assets in a FLIP NIMCRUT that pays 90% of value under tables to Grantor.	Grantor places NIMCRUT Unitrust income under LLC and sells 99% non-voting interest to Grantor Trust for note. The discount may be 50% because of the uncertainty and delay in receiving any distributions.	**Example:** $1 million of investments into CRUT for $900,000 Unitrust interest. Client gets $100,000 tax deduction. Sell 99% non-voting interest in LLC that holds CRUT payment right for $700,000 note. Savings at 40% estate tax rate and with charitable deduction will be much more than the charity receives.

Use Administrative Note Exception to Prohibited Transaction Rules.	Grandfather has $10 million worth of stock in family business and is in 40% estate tax rate. On his death, IRS will receive $4 million over 14 years, or within 9 months after date of death. --- The exception that should apply in this situation provides that a note given for the purchase of assets after the death of the owner based upon an existing option will not constitute self-dealing with respect to "estate property,"[1] regardless of when title vests under local law if the following requirements are satisfied: a. The administrator or trustee either possesses a power of sale with respect to the property, has the power to reallocate the property, or is required to sell the property under terms of any option subject to which the property was acquired. b. The transaction is approved by the probate court having jurisdiction over the estate (or by another court having jurisdiction over the estate (or trust) or over the Private Foundation). c. The transaction occurs before the estate is considered terminated for federal income tax purposes. d. The estate or trust receives at least fair market value for the interest or expectancy the purchasing entity has in the property. e. One of the following three requirements must also be met: (i) The transaction is required under the terms of an option that is binding upon the trust or estate. (ii) The transaction results in the foundation receiving an interest or expectancy at least as liquid as the one it had previously. (iii) The transaction results in the Foundation receiving an asset related to the active carrying out of its exempt purposes. f. If there are voting units issued by the company, the transaction can only involve the non-voting interest in the company.[2] This is because indirect self-dealing will occur if a Private Foundation controls the organization that is a party to the transaction with a Disqualified Person. Strict compliance with the above requirements must occur for this exception to be effective.[3] It would certainly be safest to file for a	Instead, his Will says that the stock will go to Worthy Charity, but his children will have the option to buy the stock for a long-term low interest note from the estate and owe the note to a Family Foundation that will support the school. Now the children can pay Saint Petersburg College interest on $10 million for 30 years at applicable federal rate (now just about 2% per annum or $200,000 a year, income tax deductible), instead of paying $4 million to the IRS.

To Avoid Estate Tax		
	Private Letter Ruling, assuming that an estate tax return is filed, to confirm that the IRS will not question this type of arrangement.	
Use Disclaimers:	I leave my $10 million of stock to my son, John Smith, ESQ, but if he disclaims the stock goes to the Charity, and my son can buy the stock from the Charity for an administrative note.	

On Death		
Leave a Devise to a High-Income Child Who can Donate to Charity to get a Tax Deduction.		
Variable Annuities Laden with Ordinary Income	Beneficiary can be charity in amount equal to all income in the contract within X months of death, with remainder to charity or elsewhere.	
Leave IRA and Variable Annuity Income or other IRD to Pot Trust Where Trustee Can Pay Such Amounts to Charities Until Charitable Goal is Reached		
IRA and/or Pension Payable to Charitable Remainder Trusts:	Stretch the IRA for 20 years or over a lifetime or lifetimes by making it payable to a Charitable Remainder Trust ("CRT") or FLIP NIMCRUT to avoid 10-year payout rule.	
Use Charitable Lead Annuity Trusts ("CLATs") to Zero Out Estate Tax:	Jacqueline Kennedy Onassis – **EXAMPLE:** 15 annual payments to charity with remainder to family – zero estate tax and family can expect a significant inheritance after term of years for charity.	Can arrange as a disclaimer choice – I give the rest to my daughter, but anything she disclaims goes to CLAT for charity and her.
Leave Assets to a "Non-Qualified Charitable Trust", Which can Pay its Income to Charity	The trust will not be subject to the charitable organization rules, can own S corporation stock, and have Unrelated Business Taxable Income without penalty.	Be aware of IRC § 680, which may limit charitable deductions for income that would be UBTI, if the trust was a charity.

Using Family Foundations		
Establish A Private Operating Foundation to Receive/Control Donated Assets and Interactive Joint Venture with Public Charity.	Usually the same tax result; control may remain with the family along with name recognition from the Foundation.	Must spend 4.25% of value each 3 out of 4 years and/or use set-aside.
Establish Non-Operating Private Foundation with Same Purposes as Above, But Without Active Participation Requirements.	Private Foundations are subject to deduction limitation rules that do not apply to Private Operating Foundations – Must distribute approximately 5% each year to Public Charities.	The family may control and write checks to Public Charities or engage in active Joint Ventures.
Fund an Incomplete Gift Family Foundation.	Family receives recognition from the Family Foundation name and existence, but no tax deduction until the incomplete gift Foundation makes a transfer to charity. No tax return or formalities required – considered as owned by founders.	No need to register this with the IRS, no need to give minimum distributions, simple inexpensive way to see if the family would enjoy having a Foundation or to earmark assets for charitable purposes while receiving recognition.

1. Maintaining Confidentiality When Giving to Charity

Clients who wish to remain confidential in their giving can consider the following strategies:

a. Form a limited liability company owned by the client that has its own separate name and taxpayer identification number.

The LLC can be the donor instead of the client, and the LLC will therefore be listed on charitable organization rosters and disclosure forms instead of the name of the client.

IRS rules preclude disclosure of the owner of an entity, and confidentiality can be maintained if the LLC is formed and maintained in a state that does not require or disclose ownership.

For example, Wyoming does not even require disclosure to the State of Wyoming of the manager or managers of a Wyoming LLC or its owners.

Only the IRS and the client's hairdresser may know for sure.[178]

b. To make it less likely that anyone will obtain information with respect to details or operations of a 501(c)(3) organization, put as much information as possible in exhibits to the Form 990 (attached as Exhibit D).

Presently, the IRS discloses the Form 990 but not the exhibits to the Form 990.

The authors have noticed many Form 990s where almost all the information about the entity has been provided in the exhibits because it is difficult and time consuming to request and received copies of the exhibits.

2. Self-Directed IRAs

Many real estate investors and developers have self-directed IRAs which own rental properties and will be subject to both income tax and estate tax after the death of the IRA holder.

Such IRAs can be made payable upon death to 501(c)(3) organizations that can facilitate selling the property under the IRA and receiving the sales proceeds tax-free, so as not to be subject to income tax or estate tax thereon.

Alternatively, a 501(c)(3) organization can receive a distribution of property owned by an IRA in kind. In order for the IRA owner to be able to claim the distribution as a charitable contribution, the fair market value for such distribution must be determined. Under IRC § 170(a)(1), the amount of the deduction is usually the fair market value of the property at the time of the contribution. It is the donor's responsibility to determine a fair market value for the property.

Sometimes donors over age 70 ½ have real estate in self-directed IRAs and would like to transfer the real estate to a charity based upon the $100,000 per year charitable rollover rule under IRC Section 408(d)(8). IRC § 408(d)(8)(B) provides that a qualifying charitable distribution includes any distribution from an IRA to a qualifying charitable organization so long as the distribution would otherwise be includable in gross income. This includes in-kind distributions, such as securities.

This prevents the IRA holder from recognizing income on the distribution and can be used to satisfy a legally-binding charitable pledge under Notice 2007-7, 2007-5 I.R.B. 395 – Q&A 44.

3. Donating Life Insurance Policies

Many potential donors will have life insurance policies and ongoing premium payment arrangements that can be shifted to a charity.

[178] This was a colloquial American Expression, there is no hairdresser-client privilege, but there are many nosey hairdressers.

Assuming that the donor has no legal or contractual obligation to make premium payments under a conventional life insurance policy, there is no issue with simply donating ownership of the policy to a charity and making the charity the beneficiary of the policy at the same time.

The charity will need to give the donor a receipt confirming that the charity has become the owner and beneficiary of the policy and the approximate value of the gift, in the same manner that applies for other charitable donations of property.

The value of a life insurance policy is what a willing buyer would pay a willing seller for the policy, and opinions can vary.

The charitable income tax deduction for the donation of a life insurance policy cannot exceed the lesser of the donor's basis in the policy (the sum of the premiums the donor has paid, less withdrawals) or the fair market value of the policy. The fair market value of the policy will depend on whether the policy is paid-up, newly issued, or is not newly issued but still has premiums due:

- The fair market value will be the policy's replacement value if no additional premiums are due. Replacement value is "the amount which the company would charge for a single premium contract of the same specified amount on the life of a person of the age of the insured."[179]

- The fair market value of a newly issued policy is normally equal to "the cost of the contract."[180]

- Otherwise, if the policy is not newly issued but still has premiums due the fair market value may be determined using the following formula:[181]

Interpolated Terminal Reserve Value (what the life insurance carrier actuaries determine that the company would charge for the issuance of an identical policy on the life of a person of the age of the insured, taking into account that the person is older than when the policy was issued and will consequently have a shorter life expectancy.)

+ Unearned Premium for the Current Period

+ Accrued Dividends

[179] Treas. Reg. § 25.2512-6(a) Ex. (3).
[180] Treas. Reg. § 25.2512-6(a) Ex. (1).
[181] *Charitable Gifts Of Life Insurance*, Endowment Development Services, https://www.endowdevelop.com/etech_pal/Content/other_gifts/charitable_gifts_of_life_insurance.htm (last accessed Sept. 21, 2022); Treas. Reg. § 25.2512-

- Outstanding Policy Loan
= Fair Market Value of Policy That Is Not Paid-Up

As stated above, the charitable income tax deduction is equal to the lesser of the donor's basis in the policy (the sum of the premiums the donor has paid, less withdrawals) or the fair market value of the policy.

Once the charitable organization owns the policy and is the beneficiary thereof, premium payments made will be considered to be gifts of cash to the charity for income tax deduction purposes, but it would be safer from an audit standpoint to transfer cash to the charity and let the charity make the premium payments.

Nevertheless, the charity may prefer that the payments be made directly so that the charity does not have to determine whether it is a proper investment to pay the premiums.

If the owner of the policy would have ordinary income if he cashed the policy in or sold it, then the ordinary income aspect is not a charitable deduction.

4. <u>Non-Charitable Tax Planning Alternatives for Land Not Yet Being Developed and Investment Properties Being Sold</u>

Developers holding land in a separate entity that has not yet been physically adapted for development may choose to sell the property to a related-party S corporation in order to derive capital gains income to the extent of the property's fair market value before putting a "shovel in the ground." This strategy prevents such appreciation from being subject to ordinary income tax at a later time.

The S corporation can agree to pay most of the consideration for the sale over time under an installment note so that the developer can defer the capital gains income tax until the note is paid.

In the year that payments of principal are received, the developer may elect to donate other assets to one or more charitable organizations in order to offset the capital gain with a charitable deduction.

One way to trigger the income tax and receive a fair market value income tax basis is to transfer the property or an LLC owning the property that has elected for income tax purposes to be an S corporation and then from the S corporation back to its owner. Alternatively, after transferring the property or an LLC owning the property into an S corporation, the S corporation can dissolve or elect to be treated as a partnership for income tax purposes (if the entity is an LLC or limited liability partnership that can elect to be treated as an S corporation) and then elect to be treated as if it constructively liquidated and converted back to partnership status to avoid having to make a transfer by deed.

The capital gains tax can be deferred and partly eliminated if there is a transfer made into a Qualified Opportunity Fund, so that the capital gains tax remaining will not have to be included in income until 2026, and the eventual sale more than ten years later of the business established in the Qualified Opportunity Zone will not be subject to capital gains taxes if all of the requirements are met.

An active business can include ownership and rental of apartments, condominiums, or single-family homes where the landlord is actively involved in providing a number of services to the tenants.

The other alternative that the developer has will be to facilitate an IRC § 1031 Exchange from the proceeds of the sale of the property into another investment property that cannot be classified as inventory held for sale by a dealer.

Running the numbers on all of these alternatives can help a client understand what they involve and what the end result of each alternative might be.

The results can be very positive when a developer donates land not considered to be inventory to a 501(c)(3) organization to provide a park, a school, or other accommodations that may generally enhance the value of the development without being considered to violate the private inurement rules.

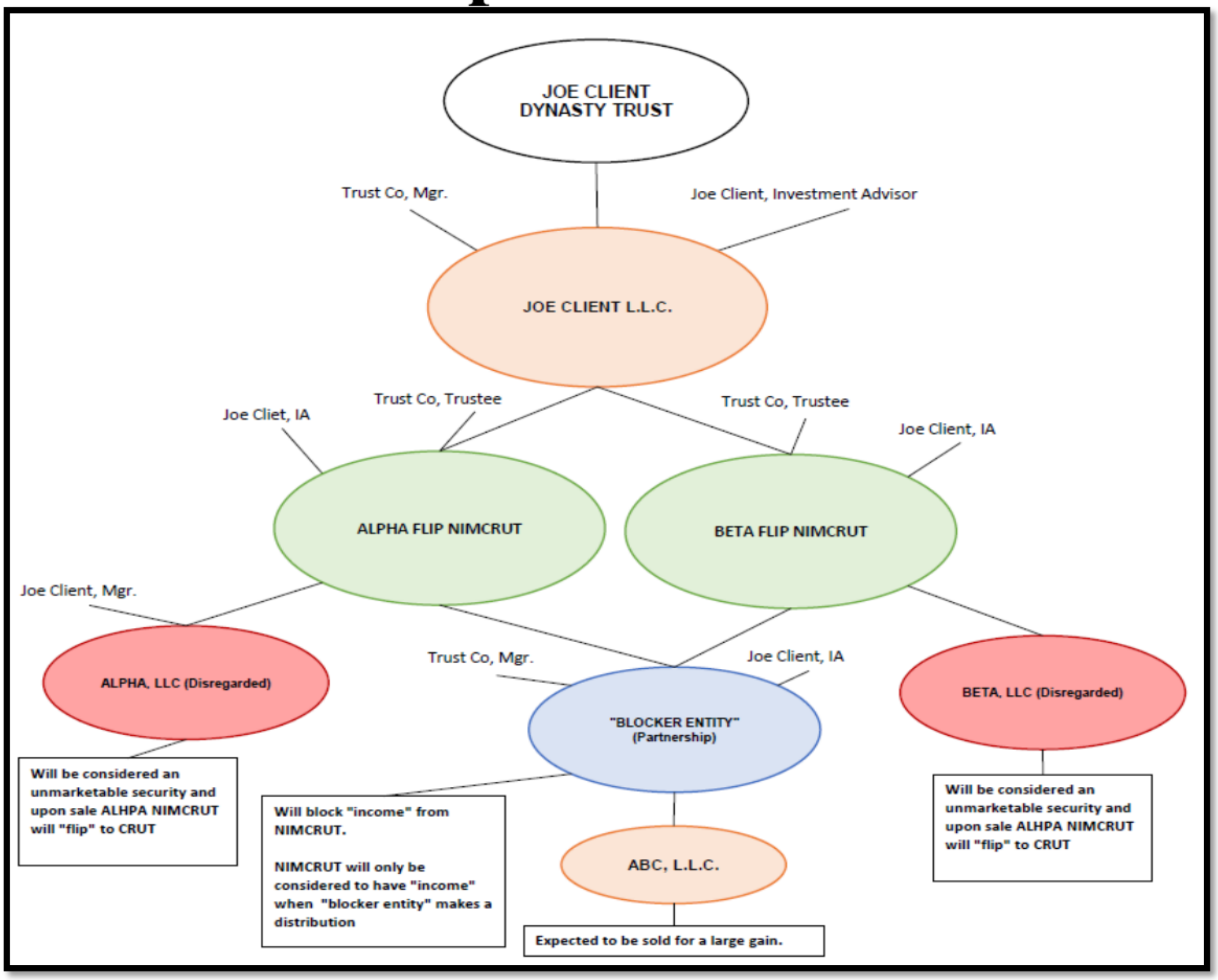
One farmer donated property to a foundation that raised cows. He used some of the excrement of the cows for his own purposes as the result of a small stream that carried it over his adjoining property. The IRS found that this violated the Private Manure-ment Rules.[182]

Another alternative would be to place the property that is not yet being developed into a Charitable Remainder Trust and to defer the capital gains income from the sale of the property by using a FLIP NIMCRUT. However, a Charitable Remainder Trust cannot sell property to a party related to the donor unless no income tax or gift tax deduction is allowable from the arrangement pursuant to PLR 202053007 (December 31, 2021) and PLR 200810016 (December 6, 2007). Unfortunately, the IRS will no longer rule on if and when the self-dealing rules will apply to a Charitable Remainder Trust.

This is further discussed in the Charitable Remainder Trust section in Chapter 2 of this book.

[182] Just Kidding

Flip NIMCRUT



* Note from the chart: When flipping, you cannot withdraw more than the original bases minus any contributions made since then. Therefore, the lower the value, the more advantageous it is with a Flip NIMCRUT.

5. Donate Before an Arm's-Length Sale–Not After

When a building is going to be sold, but before a binding contract is entered into, is it better to donate one-tenth of the property to charity, without discount, before the Sale Contract is entered into than to give one-tenth of the net sales proceeds after the sale to charity?

Donating before the Sale Contract is entered into is much better because the contributor will not only save income tax by receiving a charitable income tax deduction equal to the fair market value of the 10% donation, but the contributor will also avoid paying income tax on the appreciation attributable to the 10%.

For example, Jerry owns a building worth $1,000,000 with a $100,000 income tax basis and has taken straight-line depreciation so that there will be no depreciation recapture upon sale.

When Jerry sells the building, he will have a $900,000 capital gain and will pay $225,000 in capital gains taxes, assuming a 25% combined capital gains and Net Investment Income Tax rate.

If he donates $100,000 after the sale to a charity, then he will have a $40,000 income tax savings, assuming that he is in the 40% income tax bracket. The net tax attributable to the sale and gift will therefore be $185,000.

If he instead donates ten percent of the building to the charity and receives a $100,000 tax deduction, his sale of 90% of the building to an arm's-length purchaser will result in a net capital gain of $810,000 ($900,000 sale price minus basis of $90,000), and he will pay $202,500 in capital gains taxes, assuming a 25% combined capital gains and Net Investment Income rate.

Jerry will still receive an additional $40,000 of income tax savings by reason of the $100,000 donation, making the net tax attributable to the sale and gift $162,500. This is a $22,500 difference from if the donation to charity was made after the sale.

In addition, to avoid a possible discount because of partial ownership interest, Jerry can agree that the charity will have the right to put (demand that he purchase) the one-tenth ownership within 90 days of receiving written notice for an amount equal to one-tenth of the value of the building without discounts.

6. <u>Basic Principles for Transferring Real Estate to Charities</u>

The following describes important principles that apply to real estate and its involvement in charitable giving.

Many real estate and business-investment owners and operators love their families and charities but also love their properties and businesses. It is important that these entrepreneurs and owners be well informed about charitable opportunities and planning tactics that most tax and estate advisors do not understand.

Individuals, businesses, and affiliated entities engaged in real estate investment and development can dramatically reduce income and estate taxes and enhance creditor-protection planning by supporting charitable organizations and causes. This can be done while retaining control and flexibility.

Tax and estate planners often face challenges in understanding and explaining to their clients what arrangements are possible and how they will work. The rules are complex, and there is a lack of clear and comprehensive literature concentrating on how these rules apply to real estate investors and developers.

An interesting dynamic often exists when a senior generation member has funded significant charitable amounts to 501(c)(3) entities, Charitable Remainder Trusts ("CRT"), or

Charitable Lead Annuity Trust entities ("CLAT"). When the next or subsequent generations take control of the entities, they often wish to redeploy the financial resources away from charity in ways that are consistent with their goals.

There are ways to use charitable resources to indirectly benefit and operate businesses and investment endeavors, while qualifying for charitable purposes. In this regard, real estate investors and developers normally have four goals:

1. Retain control,

2. Obtain a charitable income and/or estate tax deduction,

3. Receive recognition, and

4. Support a charity or charitable causes.

These goals are ordered from the perspective of a tax advisor. A development officer or employees and supporters of a 501(c)(3) entity would likely arrange these goals in the opposite order.

Certain charitable endeavors can indirectly benefit a real estate developer or owner or otherwise help to satisfy an investor's non-charitable objectives. For example, the following charitable activities were used to enhance entities or properties owned or controlled by donors and are further discussed in subsequent chapters.

- In Revenue Ruling 70-585, 1970-2 C.B. 115, the IRS stated that a nonprofit was allowed to undertake the construction and renovation of <u>housing for sale to low-income families</u> on favorable financing terms by providing that "where an organization is formed for charitable purposes and accomplishes its charitable purposes through a program of providing housing for low and, in certain circumstances, moderate income families, it is entitled to exemption under section 501 (c) (3) of the Code." (Emphasis added.)

- In Private Letter Ruling ("PLR") 200634036 (April 10, 2006), the IRS permitted a nonprofit to <u>construct and operate a city-owned convention center</u>.

- In PLR 200444030 (August 5, 2004), the IRS allowed a nonprofit to <u>operate a comprehensive health center</u>, including rehabilitation and fitness functions.

- In PLR 200148057 (July 17, 2001), the IRS allowed a nonprofit to fund and operate a <u>golf course, marina, and common facilities as part of a state park system</u>.

- The authors recently assisted with a Form 1023 (attached as Exhibit B) approval of a 501(c)(3) <u>athletic and aquatic center to be built adjacent to a developer's property</u>. The presence and operations of the center will benefit the general community.

The following sections of this introduction provide an overview of the primary principles, rules, and potential issues related to the transfer of real estate to charities. A general understanding of these topics helps to better appreciate the strategies explored in Chapter 3.

The rules are fairly simple when the taxpayer or a limited liability company ("LLC") that is disregarded for income tax purposes wishes to donate real estate directly.

The donor can transfer unencumbered real estate or the ownership of an LLC that owns such real estate to the 501(c)(3) charitable organization. The donor can receive an income tax deduction equal to the fair market value of the property given, to the extent that the donor would have had long-term-capital-gain treatment if the property had been sold.

Alternatively, the charitable income tax deduction will be limited to the basis of the property, instead of being based upon fair market value, if the donor either:

(1) has not held the property for a full year and therefore would receive short-term-capital-gain treatment on sale of the property, or

(2) to the extent that the property has been depreciated by the taxpayer using an accelerated depreciation method that causes depreciation recapture to be recognized upon sale.

The physical aspects of many buildings, such as plumbing, electrical, and other systems, are often subject to component depreciation upon acquisition, which would be recaptured on sale as ordinary income, or at the 25% rate depending upon the kind of depreciation taken. These physical aspects must be separately valued at the time of donation and will not be deductible except possibly to the extent of their remaining basis.

Variations to the above rules create interesting dynamics:

<u>20% of AGI Limit / Taxable Basis Limit for Non-real Estate Contributions to Private Non-Operating Foundation</u>

- Appreciated real estate (and other assets not constituting marketable securities) donated to a private non-operating foundation is only deductible based on the income tax basis of the asset (which is normally cost minus depreciation taken), up to 20% of the adjusted gross income for the taxpayer in the year of donation. Any excess deduction can be carried forward annually for up to five additional tax years.

<u>Appreciated Securities Deductible at Fair Market Value – 20% AGI Limit</u>

- Appreciated securities donated to a private non-operating foundation are deductible based on their fair market value if it exceeds the taxpayer's basis, subject to the 20%-of-adjusted-gross-income limitation. However, other appreciated capital gains assets are not deductible at fair market value when donated to a private non-operating foundation. Many charitable families form Private Operating Foundations in order to receive a fair market value income tax deduction for donating assets other than appreciated securities.

30% Limit for Appreciated Assets Transferred to Private Operating Foundation or Public Charity

- When appreciated real estate or other property is donated to a Private Operating Foundation or a Public Charity, the deduction of the fair market value of the property cannot exceed 30% of the donor's adjusted gross income for the year of the gift, but the deduction will carry forward for up to 5 consecutive years afterward.

50% AGI Limit for Donation of Non-Appreciated Assets to Private Operating Foundation or Public Charity

- The deduction for the donation of non-appreciated assets to a Private Operating Foundation or Public Charity can be based on up to 50% of adjusted gross income.

- A taxpayer donating appreciated property may elect to have a tax deduction equal to the basis of the property, instead of its fair market value, in order to use the 50%-of-adjusted-gross-income limitation.

- A taxpayer may also donate a partial ownership in real estate instead of a 100% interest.

Many lawyers use charitable overflow language like the following when drafting trusts for charitable individuals:

> Overflow Donation to Charitable Organization. In the highly unlikely event that the Grantor's contributions to this Trust exceed the maximum amount that can be gifted by the Grantor without incurring Federal Gift Tax or Federal Generation Skipping Tax, then the Trustee shall divide the Trust estate into two separate shares, hereinafter designated as the 2022 SMITH GIFTING TRUST SHARE and the 2022 SMITH GIFTING TRUST CHARITABLE CONTRIBUTION SHARE. The 2022 SMITH GIFTING TRUST SHARE shall be a fraction of the Trust estate of which (a) the numerator shall be the largest amount that if allowed under the Federal Estate Tax Exemption and the Federal Generation Skipping Tax Exemption would result in no Federal Gift Tax and no Federal Generation Skipping Tax being payable by the Grantor by reason of the gift to this Trust, and (b) the denominator shall be the value as finally determined for Federal Gift Tax purposes of the assets in the Trust estate immediately after such gift that would have otherwise caused gift tax to be imposed has been made. The 2022 SMITH GIFTING TRUST CHARITABLE CONTRIBUTION SHARE shall be the remainder of the Trust estate. No property shall be allocated to the 2022 SMITH GIFTING TRUST CHARITABLE CONTRIBUTION SHARE that would not qualify for the Gift Tax Charitable Deduction. The 2022 SMITH GIFTING TRUST SHARE shall

> be held, managed, and administered pursuant to the terms of Section 4.02 and Article Five of this Trust. The 2022 SMITH GIFTING TRUST CHARITABLE CONTRIBUTION SHARE and any and all income derived thereon shall be transferred directly to a recognized community foundation which qualifies as a public charitable organization under Internal Revenue Code Section 501 (c)(3), or the trustee may choose to establish a new 501(c)(3) trust that qualifies for the Federal Gift Tax charitable deduction under Internal Revenue Code § 2522, and the assets of such trust shall be devised immediately and without delay to one or more 501(c)(3) organizations established and/or chosen by the Trustee, provided that any such charitable organization or organizations and the process of selection and formation shall be such that the disposition to charity set forth herein shall qualify for the federal estate tax charitable deduction, notwithstanding any provision herein to the contrary.

7. <u>A Real Estate Developer's Dealer Property (Inventory) Gifted from a C Corporation to Be Used Solely for the Care of the Ill, Needy, or Infants</u>

The deductibility of real estate or other assets that are considered to be the inventory of a dealer is limited to an amount not to exceed inventory's tax basis. However, this limit does not apply if the charitable contribution of the dealer's property is made by a C corporation to a Public Charity or Private Operating Foundation that uses the property solely for the care of the ill, the needy, or infants under IRC § 170(e)(3).

The tax deduction received by the C corporation will be the lesser of:

- Two times the tax basis of the property; or
- The basis of the property, plus one-half of the appreciation thereon.

For example, if a C corporation owns property held for sale that is worth $1,000,000 and has a tax basis of $400,000, the amount deductible will be $700,000 because $700,000 is less than $800,000.

Please note that a C corporation cannot deduct more than 10% of its otherwise applicable taxable income, regardless of whether the property donated is long-term capital gains property, has been subject to accelerated depreciation, is inventory, or is short-term capital gains property. The 10% limitation was temporarily increased to 25% for the tax years 2020 and 2021.

When the 10% amount has been exceeded, the five-year carry forward rule allows a contribution by a C corporation to be deducted in the year of the contribution and the next five tax years afterward.

8. <u>The Tax-Neutral Dedicated Charitable Trust: A Simple and Inexpensive Way For Families To Commit Funds Or Assets To Charitable Purposes</u>

Many taxpayers consider establishing charitable trusts and foundations to make a visible commitment to charitable purposes.

One advantage of having a family-controlled charity is an immediate income tax deduction for contributions that may be held by the entity and used over time for charitable purposes.

Other advantages include recognition of the family's commitment, the ability to operate as a charitable organization, involvement of family members in charitable endeavors, and the sense of satisfaction that comes from making a commitment and following through on an individualized basis.

In many situations, the tax deduction from the contribution is not important, because the family may not be in a high income-tax bracket, the family may already be using whatever tax deductions are available for donations, or the family may have losses or large deductions that make the charitable income-tax deduction of little use, or better deferred to a future year when the donors may be in a higher income-tax bracket.

A major "turnoff" for families establishing charitable foundations and trusts includes the need to pay professional fees and the $600 application fee to the IRS, and to file a Form 1023 Application to obtain 501(c)(3) status, which is generally more time consuming and expensive than forming the organization. Additionally, there is the need to file annual Form 990s, and other formalities that have to be followed by a 501(c)(3) organization, along with the knowledge that the Form 990 will be available to the general public on www.irsgov/pub/irs-pdf/f990.pdf and that the 1.39% net investment income tax will be paid annually.

Another downside of operating a charitable foundation is the requirement that it distribute at least 5% of the foundation's assets each year to other charities, or to spend 4.25% of the foundation's assets each year on the active conduct of a charitable activity. Although the foundation's assets may grow faster than 5% per year, there is a chance that the investments may not reach this level of return, or the charitable donor may not want to distribute funds every year.

The foundation is also greatly restricted when it comes to dealing with related persons, even if such dealings are at arm's length or benefit the foundation more than the related person.

As a result of the above, some charitable taxpayers will choose to establish a deferred-deduction Charitable Trust, which may be recognized and exist as a charitable organization under state law, while being considered to be "disregarded" and continued as owned by the taxpayer for federal income tax purposes.

Other than the above, the only difference between a typical 501(c)(3) charitable trust and a trust that can be disregarded for federal income-tax purposes is that the disregarded trust benefits not only Section 501(c)(3) charities, but also tax-exempt organizations that can include police and firemen benevolent associations (under Section 501(c)(8)) and cemetery associations (under Section 501(c)(13)). This entity will not need to meet annual distribution requirements and the grantor can exchange trust assets for assets of equal value and/or add charitable organizations as beneficiaries of the trust.

Let's take, for example, John and Molly DoGood, who are retired schoolteachers. They have always wanted to use $250,000 from a large inheritance that John received to set up a scholarship and mentorship program for disadvantaged high school students who would probably not go to college without having extra financial and moral support.

John and Molly are in the 24% tax bracket, and have $120,000 of adjusted gross income, so they can donate up to $72,000 to a private operating foundation, or $36,000 to a private foundation, each year without their income tax deduction being limited based upon applicable adjusted gross income limitations. They would like to create a private foundation and donate $36,000 each year to fund scholarships, saving up to $8,640 in taxes each year.

John is in poor health and wants to make sure that the funds are used for these purposes "no matter what happens," and they have been working with a local community college that can accept donations and award the scholarships, while giving recognition to John and Molly's charitable trust and efforts.

John and Molly form the John and Molly DoGood Charitable Foundation, and John places the $250,000 into a trust account, and they receive recognition from the community college and can operate as a "family foundation" from a publicity and community support standpoint.

John and Molly run the trust and receive an income tax deduction for the monies that pass each year from the trust to the community college, and do not have to file a Form 1023, Form 990s or any other documents.

Their activities remain private, to the extent permitted under state law, and in compliance with the terms of the trust.

At a later time, they may choose to convert the trust to qualify as a 501(c)(3) charity by excluding non-501(c)(3) organizations from receiving further benefits, filing a Form 1023 and then filing annual Form 990s, and otherwise complying with the rules that apply for such organizations.

9. <u>Selection of Entity – Charitable Trust or Corporation – Unrelated Business Income Tax Differences</u>

There are two kinds of state law entities that can qualify for 501(c)(3) status:

1. The not-for-profit corporation, and

2. The not-for-profit trust.

The authors often prefer using a charitable trust because there is no need to register a charitable trust with the Secretary of State in most states, file annual reports, or pay annual fees to enable the entity to continue to exist.

Also, the identity of a charitable trust normally remains confidential from the Secretary of State because there is no Secretary of State filing, annual report, or disclosure required for a trust.

However, disclosure is required under the IRS regulations and procedures for both charitable corporations and trusts.

The one significant difference between tax treatment of a 501(c)(3) charitable trust and a 501(c)(3) corporation is that the tax on UBTI is at C corporation rates for 501(c)(3) corporations and complex trust rates for 501(c)(3) trusts.

Corporations are taxed at a flat rate of 21% and complex trusts are taxed at a relatively low rate of 10% on the first $2,750 of income (for 2023). Complex trusts, however, are taxed at 37% when the income reaches $13,450. A 20% deduction under Internal Revenue Code Section 199A may be available for 501(c)(3) entities that pay tax on UBTI.

The tax brackets for a complex trust's taxable income for 2023 are as follows:

Taxable Income:	The Tax Is:
$0 to $2,900	10%
$2,901 to $10,550	$290 plus 24% of the amount of taxable income exceeding $2,750
$10,551 to $14,450	$2,126 plus 35% of the amount of taxable income exceeding $9,850
$14,451 and up	$3,491 plus 37% of the amount of taxable income exceeding $13,450

$3,239 divided by $13,450 is approximately a 24% tax bracket on the first $13,450 of income.

Complex trusts are able to deduct certain charitable distributions under IRC § 642(c) if the original governing instrument permits such distributions to be made to charity, subject to the exceptions set forth below.

One exception is when the contribution is made by a partnership in which the trust is a partner. For example, the trust could transfer assets to a partnership and the partnership could make charitable contributions that will be reported as deductions on the trust's income tax return as the result of K-1 flow-through reporting. As mentioned above, the governing instrument must permit the distribution be made to charity for the contribution to be deductible. If the governing instrument fails to do so, the trust is precluded from taking such deduction under § 642(c). However, when a trust is a partner in a partnership, the governing instrument for contributions made by the partnership is the partnership agreement.

For example, consider a situation in which a trust contributes income-producing assets to a partnership in exchange for a partnership interest. Subsequently, the assets produce income, and the partners decide to contribute a portion of that income to a charitable organization. The contribution made by the partnership will be deemed to be paid by the partnership-interest portion of the trust and the trust can deduct such contribution.

10. The § 642(c) Trap For "Unrelated Business Income" And Deductions Attributable to Tax-Exempt Income

a. UBTI Equivalent Limitations

To prevent complex trusts from having business or debt-financed income offset by the IRC § 642(c) deduction, § 681(a) limits the 642(c) deduction under certain circumstances.

IRC § 681(a) defines "unrelated business income" of a trust to mean the amount that would be computed to be its "unrelated business taxable income" under IRC § 512 if the trust was a 501(c)(3) organization.

This causes business income—including rent that is based upon the profits of a tenant, rent of personal property that is more than incidental to the leasing of real estate, and the sale of property by a trust that is a "dealer"—to be offset only in a limited manner by distributions that the complex trust makes to charity. The deduction permitted to charitable organizations that have UBTI and distribute it to other charitable organizations, as discussed in earlier parts of this book, also applies to complex trusts.

Further, Treas. Reg. § 1.681(a)-2 permits a Trust Agreement to specify the source of charitable contributions in order to avoid a pro rata allocation.

For example, assume a complex trust has:

- $10,000 of tax-exempt municipal bond income,
- $40,000 of net income from an active business not related to charity, and
- $50,000 of rent income that is determined without relation to the income of the tenant.

Under this scenario, if the Trust Agreement does not specify how to allocate income for a contribution, a $25,000 transfer to a 501(c) charity would be deductible based upon only 50% of the transfer, so the permissible deduction would be $12,500.

Alternatively, if the trust document specifies that distributions to charities will be made first from income that would not be considered to be either "unrelated business income" under IRC § 681(a) or tax-free income under IRC § 103, then a $25,000 tax deduction would be available (instead of a $12,500 tax deduction).

b. The Regulation of "Nonexempt Charitable Trusts" (a.k.a. "Good Deed Trusts") Under IRC Section 4947(a)(1)

Recognizing that complex trusts could be used to generate income tax deductions under IRC § 642(c), Congress acted in 1969 by imposing Private Foundation regulatory requirements upon trusts that are not exempt from income tax but provide similar tax results because of the income tax deduction under IRC § 642(c).

It is worth noting that the Internal Revenue Code subjects non-tax-exempt charitable trusts to many of the same requirements as Private Foundations in order to prevent taxpayers from establishing trusts to avoid the Private Foundation restrictions and requirements.

An example of a Nonexempt Charitable Trust is a trust established under IRC § 4947(a)(1) to qualify for the exception to the self-dealing rules that applies when a trust owns voting stock of an entity that is held no more than 35% by the donor or individuals considered to be related to the donor.

To avoid this issue, the trust can specifically provide that it will be held not only for potential charities <u>but also for entities that do not qualify as 501(c)(3) charities</u>, such as cemetery associations, police and firemen benevolent associations, and for individuals who fall under finite categories, such as individuals who have been employed by certain "ascertainable" companies that were owned or operated by the grantor.

The exact language of IRC § 4947(a)(1) reads as follows:

> (a) Application of tax.--
>
> > (1) Charitable trusts. For purposes of part II of subchapter F of chapter 1 (other than section 508(a), (b), and (c)) and for purposes of this chapter, a trust which is not exempt from taxation under section 501(a), <u>all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and for which a deduction was allowed under section 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522</u> (or the corresponding provisions of prior law), shall be treated as an organization described in section 501(c)(3). For purposes of section 509(a)(3)(A), such a trust shall be treated as if organized on the day on which it first becomes subject to this paragraph.[183]

11. <u>Leaving Development or Investment Properties and Activities to Charity on Death</u>

Many donors want their businesses and properties to continue on forever. Because there are limitations about what can be done within a charity, there is a certain way that this must be done.

If an investor is subject to a $12,920,000 dollar estate tax exemption, he or she can leave $12,920,000 dollars to a trust for both charitable and private purposes. This trust is not subject to estate tax, can own S corporation stock, and can distribute money to friends and charities.

[183] Emphasis added.

The remainder of the assets can be placed into a 501(c)(3) foundation for charitable purposes that friends or family can run. The charitable purpose could be a school, hospital, church, or other organizations.

It is noteworthy that a Private Foundation can own non-voting stock in a for-profit C corporation that is managed by a Disqualified Person.

A Disqualified Person is able to manage the C corporation through a trust (as described further in the Section entitled "The 35% Beneficial Interest Exception" below) in which 35% of the trust is for the benefit of Disqualified Persons and the other 65% is for the benefit of charity or via a 501(c)(4) organization. The trust or 501(c)(4) organization can own a 1% voting interest in the C corporation with the Disqualified Person and the foundation owning the non-voting stock. This strategy, as permitted under IRC § 4946(a)(1)(g), puts an otherwise Disqualified Person in a fiduciary capacity as trustee of the trust.

The income tax considerations depend on the type of entity owned by the Private Foundation:

- If the foundation owns a profitable C corporation, there is no income tax on dividends paid to the foundation.

- If the foundation owns an S corporation, the foundation will be taxed at the 100% bracket on all of its K-1 income and any income from redemption or sale of S corporation ownership.

- If the foundation owns a partnership interest, there are additional considerations, but these may be avoided by placing the partnership interest into a C corporation that will be owned by the foundation. However, the transfer of a partnership interest to a C corporation can trigger income tax.

There should be careful attention paid to assuring that the corporation is separate from the foundation.

12. <u>The Administrative Note Exception</u>

Many philanthropic families leave all assets above the estate tax exclusion amount to charity in order to completely avoid federal estate tax, but there is an alternative that many advisors are not aware of.

A provision of the Estate Administration Exception[184] (discussed in Chapter 4) provides an exception to the self-dealing rules that can significantly benefit estates that leave assets to Private Operating Foundations.

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[184] Treas. Reg. § 53.4941(d)–1(b)(3) (as amended in 1973).

Under this exception, the self-dealing rules will not apply where a Disqualified Person is entitled under an option agreement meeting certain requirements to purchase assets from an estate or the revocable trust of a decedent that would otherwise pass to a 501(c)(3) charity.

In other words, on the death of a person who leaves assets to charity, the tax law may permit the family or other trusts left by that person to buy assets from the estate or revocable trust for a note that is owed to the foundation after the person's death.

This can be a useful tool to provide family members with the option to purchase business interests that would otherwise go to charity upon a decedent's death, subject to a number of requirements listed in the above-mentioned regulations.

The basic requirements to qualify for this treatment are as follows:

a. The note must require the payment of at least interest only and must balloon within 25 years of when it is made. It must be made after the death of the philanthropic individual and during the reasonable term of administration of the individual's trust or estate.

It appears that the use of the Applicable Federal Rate, which is promulgated monthly by the Internal Revenue Service and generally correlates to the rate of interest that the government is paying on newly issued 10-year Treasury Bills, can be used for notes exceeding 9 years in duration.[185] As of February 2024, the long-term Applicable Federal Rate is 4.18%. It is worth noting that the rules permit a 25-year interest only note, which can be at the long-term applicable federal rate, but the note cannot be renegotiated as long as it is owed to a Private Operating Foundation. Once the Private Operating Foundation is converted to a Public Charity, the note may be renegotiated.[186]

b. The note must be equal in value to the asset or assets that it was used to purchase. This will happen if the applicable federal rate was used pursuant to Treasury Regulation Section 25.2512-4, which indicates that a note is equal in value to its face amount for federal estate and gift tax purposes. It is noteworthy that the interest should be compounded semiannually in order to comply with IRC § 1274(d).[187]

c. If an Option Agreement is not in place before death, then the following requirements must be met:

i. The foundation must receive an interest or expectancy at least as liquid as the one given up. Fortunately, Private Letter Rulings have indicated that ownership of a 99% Non-Voting Member Interest in an LLC owning a promissory note is at least as liquid of the ownership of a business company,[188] or

[185] I.R.S. Priv. Ltr. Rul. 201129049 (Apr. 26, 2011).
[186] LISI Charitable Planning Newsletter #280 (March 11, 2019) at http://www.leimbergservices.com Copyright 2019 Leimberg Information Services, Inc. (LISI) Reproduction in Any Form or Forwarding to Any Person Prohibited Without Express Written Permission.
[187] Jerry M. Hesch, Esq.; Alan S. Gassman, Esq.; and Christopher J. Denicolo, Esq., *Interesting Interest Questions: Interest Rates for Intra-Family Transactions, Estates, Gifts and Trusts Journal*, BNA Tax Management (2014).
[188] I.R.S. Priv. Ltr. Rul. 201446024 (Aug. 21, 2014).

ii. The foundation must receive an asset related to the active carrying out of its exempt purpose.

iii. For most arrangements, there should be an Option Agreement in place before the death of the philanthropic individual that gives the family member or entity the right to purchase the asset or assets on the terms set forth above.

iv. The transaction must be approved by the probate court having jurisdiction over the estate.

While the Estate Administration Exception is specifically provided for under the Self-Dealing Rules for situations where there is a relationship between a private foundation and the philanthropic family, we see no reason that this technique cannot be used with respect to dispositions to Public Charities.

One question is whether the family can satisfy its obligation to the charity by negotiating to prepay the note at a significant discount. There is nothing in the Estate Administration Exception, or the related literature known to us, to prevent an arm's-length prepayment discount from being negotiated with the charity. However, there may be self-dealing concerns. This prepayment would typically happen after the IRS has had the opportunity to review the Estate Tax Return, Form 706, and the deadlines have passed for audits and changes to the return.

Another question is how the entity that signs the note can budget to pay the note when it balloons in year 25 or before then.

There is a possible self-dealing issue when interest payments are made on the promissory note after the estate administration period ends. It appears that the safest course of action would be to place the note into an LLC and have the Disqualified Person purchase a 1% voting interest in the LLC. The 99% non-voting interest can then be distributed to the foundation, along with the cash the LLC received from the Disqualified Person in exchange for the 1% voting interest.[189] The foundation is deemed to hold an interest in the LLC and not the note that it holds.[190]

[189] I.R.S. Priv. Ltr. Rul. 201446024 (Aug. 21, 2014).
[190] I.R.S. Priv. Ltr. Rul. 201407023 (Nov. 18, 2013).

CHART 1: Zero Estate Tax Plan for Charitable Families with Administrative Note Purchase

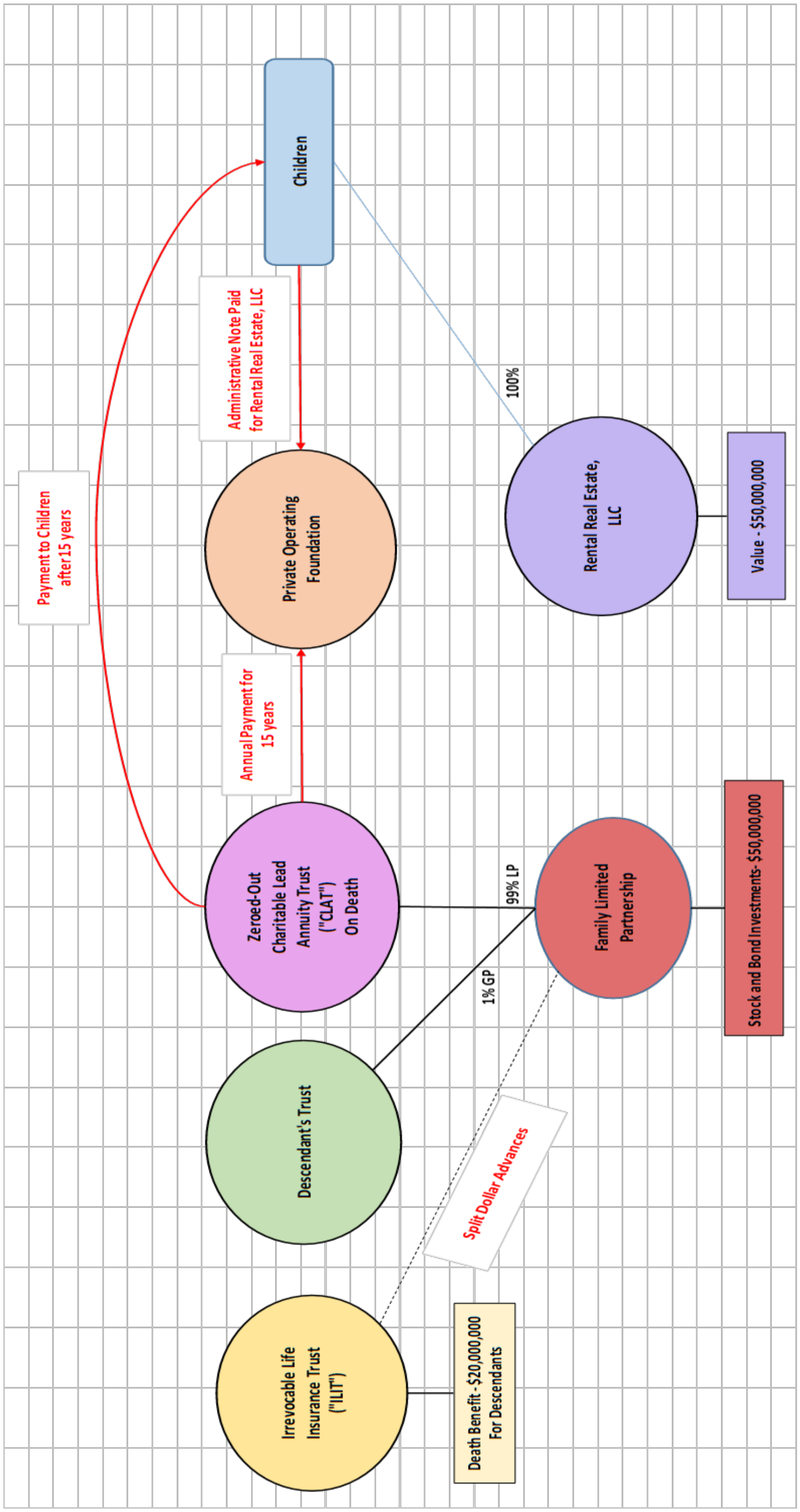
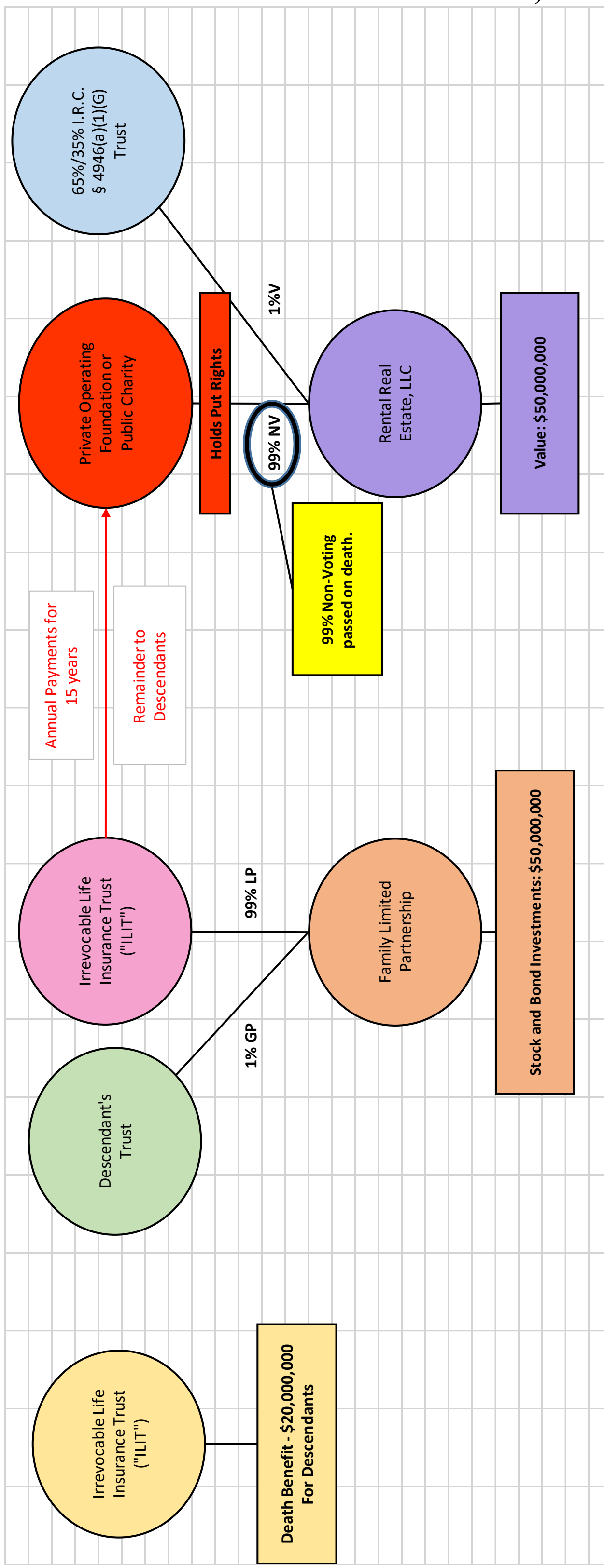


CHART 2: Zero Estate Tax Plan for Charitable Families, Alternative Structure



13. Giving Before Death

If a donor plans to leave significant appreciated assets on death, consider triggering capital gains on business and investment assets that will be held in a C corporation after his or her death:

> **Triggering Gain for Future Tax Savings** - Individuals who are inclined to leave an operating company to charity on death, but keep the assets until then, should consider the possibility of triggering capital gains on the business and investment assets that will be held in the C corporation after death, and donating to charity in the year of triggering the gain, in order to allow the C corporation that will operate after death to have a higher income tax basis in its assets, and higher depreciation deductions, to reduce the tax that will be paid by the C corporation both before and after the owner's death.[191]

14. Receiving a Charitable Deduction for the Contribution of a Remainder Interest in Personal Residence or Farm

IRC § 170(f)(3)(B) provides that a charitable income tax deduction is allowed for a contribution, not in trust, of a remainder interest in a donor's personal residence or farm. A farm is defined for this purpose as land used for the sustenance of livestock or for the production of crops, fruits, or other agricultural products. Livestock includes cattle, pigs, horses, mules, donkeys, sheep, goats, chickens, turkeys, pigeons, and other poultry.[192]

The income tax deduction is equal to the present value of the charity's remainder interest at the time the gift is made. The calculation is made using the guidelines described in Treas. Reg. § 1.170A-12 and is based on the following:

- The fair market value of the property (including improvements) on the date of transfer;
- The fair market value of depreciable improvements attached to the property on the transfer date or depletable resources associated with the property on the transfer date;
- The estimated useful life of the depreciable improvements;
- The estimated salvage value of the depreciable improvements at the end of their useful life; and
- The IRS 7250 rate at the time of the gift.

[191] LISI Charitable Planning Newsletter #280 (March 11, 2019) at http://www.leimbergservices.com Copyright 2019 Leimberg Information Services, Inc. (LISI) Reproduction in Any Form or Forwarding to Any Person Prohibited Without Express Written Permission.
[192] Treas. Reg. § 1.170A-7(b)(4) (as amended in 1994).

A charitable contribution of an encumbered personal residence or farm is not prohibited by the Internal Revenue Code or the Treasury Regulations. Treasury Regulation § 1.1011-2(a)(3) provides that, "[i]f property is transferred subject to an indebtedness, the amount of the indebtedness must be treated as an amount realized for purposes of determining whether there is a sale or exchange to which [the rules for a bargain sale to a charitable organization] apply, even though the transferee does not agree to assume or pay the indebtedness."

In PLR 9329017 (April 26, 1993), a donor purchased a farm for $110,000, which he financed by paying $30,000 in cash and obtaining a mortgage for $80,000 from a financial institution. The donor proposed to donate a remainder interest in the farm to charity while remaining liable for payment of the mortgage. The IRS ruled that because the property would be transferred subject to a mortgage, the transfer would be considered to be a bargain sale between the donor and the charity. The IRS stated that the donor would be allowed a charitable deduction for the remainder interest of $30,000. Any subsequent payment of the principal of the mortgage by the donor would be regarded as being partly a donation of a remainder interest and partly a payment that is allocated to a life estate in the property based upon the standard life estate/remainder interest tables applicable at the time each principal payment is made.

15. <u>Planning with Multiple Owner S Corporations – Partnerships of S Corporations Are Often Preferred</u>

Suppose that a taxpayer has several restaurants owned two-thirds by S corporations owned by him and one-third owned by an S corporation owned by his partner.

The S corporations can be converted to C corporation status before two-thirds (2/3rds) ownership is gifted or left on death to charity. However, the one-third shareholder does not want this to happen because it will cost him more in taxes.

This is much less flexible than when a restaurant is owned by an S corporation owned two-thirds by the Taxpayer and one-third by his or her partner, because the one third partner will typically not want to convert the entity to C corporation status.

16. <u>Leave the Estate Tax Exemption Amount to a "Non-Charitable Trust" on Death</u>

Charitable individuals who plan to leave "almost everything to charity" should consider leaving their estate tax exemption amount (the amount that can pass estate-tax-free) to a Good Deeds Trust established for charitable purposes—but without qualifying under IRC § 501(c)(3) or any other 501(c) category. Such a trust is not subject to the various limitations and prohibitions that apply to not-for-profit entities. The trust can register as an Electing Small Business Trust ("ESBT"), own S corporation stock or membership interests, and use the profits from the S corporation interests to help the same individuals and/or causes that a 501(c)(3) would support. The trust can also support individuals who could not be helped by a 501(c)(3), such as family, friends, and political causes.

A trust will qualify as an ESBT if:

1. All trust beneficiaries would be eligible shareholders if the stock was directly held (note that all potential current beneficiaries[193] of trust income or principal are treated as shareholders of the S corporation[194] and count toward the 100-shareholder limit[195]);

2. No beneficiary pays for their ownership in the ESBT; and

3. The trust files a Form 2553 ESBT election with the IRS.[196]

For example, a restauranteur may want educational and retirement benefits given to ex-employees of the restaurants and their families after his death. This cannot easily or safely occur under a 501(c)(3) organization but could occur under a non-501(c)(3) trust. The trust could also give bonus compensation to key employees above and beyond what might be "reasonable and necessary," which is not permitted for employees of entities owned by a 501(c)(3) organization.

When S corporation stock is held by an individual or his or her revocable trust and will pass to a Charitable Lead Trust or Charitable Remainder Trust after death, the estate or revocable trust will have two years from the date of death to liquidate the stock.

A Qualified Subchapter S Trust ("QSST"), which is similar to a grantor trust, can hold S corporation stock where the remainder interest is going to charity. This type of planning will work well for a QTIP (a "Qualified Terminable Interest Property Trust"). A QTIP Trust allows a taxpayer to transfer assets into a trust that will pay all income to his or her spouse for such spouse's lifetime. If a proper election is made, the transfer can qualify for the federal gift tax marital deduction, but the QTIP Trust assets will be considered to be assets of the surviving spouse for estate tax purposes on the surviving spouse's death.

The surviving spouse can offset the tax impact of the QTIP Trust assets on his or her estate by directing that they go charity on his or her death and thereby qualify for the estate tax charitable deduction. This charitable disposition can be written into a trust document, or the surviving spouse can direct the charitable disposition by exercise of a Power of Appointment that directs how the trust passes on his or her death.

However, in order for the QTIP Trust assets to be eligible for the estate tax charitable deduction, the assets must be required to go to charity. The assets will not qualify for the deduction if the Trustee is given discretion to donate the assets.

Nevertheless, the surviving spouse can decide whether to exercise his or her Power of Appointment to charity or to leave this to the discretion of the Trustee. If there will be no estate tax imposed, it may be best to allow the income of a trust that continues after the death of the surviving spouse to go to charity. This can reduce the amount of income taxes that

[193] I.R.C. § 1361(e)(2).
[194] I.R.C. § 1361(c)(2)(B)(v).
[195] I.R.C. § 1361(b)(1)(A).
[196] I.R.C. § 1361(e).

would surviving spouse can decide whether to exercise his or have to be paid. A transfer upon death to charity does not qualify for an income tax deduction unless the charity receives the devise in the form of income from an ongoing trust or other entity. Any federal estate taxes owed under a QTIP Trust on the death of the surviving spouse will be paid from the trust assets unless the surviving spouse's estate plan provides otherwise.

Note that the default federal rules for the apportionment of estate taxes (the allocation of who bears the burden of any estate tax due) under IRC § 2207A provides that the executor can recover estate taxes apportioned to a QTIP Trust and from beneficiaries who have received trust distributions. However, Treasury Regulation § 20.2207A-1(d) provides that, "[t]here is no right of recovery from any person for the property received by that person for which a deduction was allowed from the gross estate if no tax is attributable to that property."

17. Arm's Length Note to Public Charity

Due to the fact that the self-dealing rules under IRC § 4941 do not apply to Public Charities, a "Disqualified Person" is permitted to purchase assets from a Public Charity for fair market value by issuing a promissory note with arm's-length terms.

It is noteworthy that to qualify for the federal estate tax charitable deduction, the will, or trust of a deceased person only has to specify that the personal representative or trustee of the estate or trust must transfer the assets to a charitable organization and specify which charitable organization or organizations will receive this. In fact, the will or trust can simply indicate that the charitable organization can be formed after the death of the person leaving it to charity, and the organization formed or selected can be a Private Foundation and allow the estate to qualify for the estate tax charitable deduction.[197]

18. Dispositions to Charity under *McCord/Petter* Type Family Installment Sales

In the 2006 Fifth Circuit opinion *Succession of McCord v. Commissioner*[198] and the 2009 Tax Court opinion *Estate of Petter v. Commissioner*,[199] taxpayers sold privately owned investment and corporate interests to trusts for descendants in exchange for notes. The sale agreements included adjustment clauses that provided that any value in excess of the agreed sales price would pass at the time of the sale to a 501(c)(3) Public Charity in a manner intended to qualify for the federal gift tax charitable deduction.

At the same time, the transactional documents provided for a small portion of the business entity to pass to the 501(c)(3) charity. The 501(c)(3) reviewed and participated in the negotiation of the documents and also reviewed the valuation reports, presumably exercising appropriate fiduciary duties to ensure that the organization was properly represented.

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[198] 461 F.3d 614 (5th Cir. 2006).
[199] 98 T.C.M. (CCH) 534 (2009), *aff'd*, 653 F.3d 1012 (9th Cir. 2011).

One apparent reason for use of the charitable overflow arrangement was to overcome the IRS's argument that adjustment clauses are contrary to public policy because they prevent the IRS from recharacterizing value. In *McCord* and *Petter*, the courts found that it is not a violation of public policy for an adjustment clause to provide that excess value determined to exist for gift tax purposes must go to charity.

Under the *McCord* and *Petter* arrangements, a small sliver of the applicable family entity was clearly treated as going to charity at the moment of sale. The question was whether a larger percentage of the entity was actually transferred to the charity at the time of the sale.

In other words, the agreements did not indicate that the charity was receiving a percentage of the company and would later receive a greater percentage if determined appropriate by a court of competent jurisdiction. Instead, the agreement indicated that the charity was receiving a percentage of the company sufficient to not be considered a gift made to the family trust that was purchasing the rest of the company for a fixed dollar amount.

For example, assume that the sales price was $1 million for 25% and the charity received 1% at the time of the transfer. If the Tax Court found that 25% of the entity was really worth $2 million, the charity would be receiving 13.5% at the moment of the transaction. The parties would then correct the percentages of ownership and provide makeup payments to take into account that the charity actually received 13.5% instead of 1% at the time of the sale.

This brings to question whether the excess transfer qualifies for an income tax deduction. Specifically, will the taxpayer know within three years of filing the income tax return for the tax year in question whether the charitable contribution is actually greater than what is reported on the income tax return? Fortunately, the complicated Internal Revenue Code provisions relating to the mitigation of the statute of limitations may provide relief if a gift tax audit conducted more than 3 years after an income tax return is filed concludes that a charitable gift was made.

19. The 501(c)(4) Strategy

Note to reader: *This section originally appeared in the January 12, 2023 edition of the Estates, Gifts & Trusts Journal™ from Bloomberg Tax as "The 501(c)(4) Strategy" by Alan Gassman, Karl Mill, and Peter Farrell.*[200] *It is reproduced here with permission.*

Recent news (in 2022) of a $1.6 billion donation of a company to a 501(c)(4) Social Welfare Organization that will be used at least in good part to pay for political campaigns, political contributions, and political activities brings to light the opportunity that people have to allow otherwise taxable income to support their political aims.

An entity qualifies under IRC 501(c)(4) if it constitutes an "organization[] not organized for profit but operated *exclusively for the promotion of social welfare*" and "no part of the net

[200] Alan Gassman, Esq., Karl Mill, Esq., and Peter Farrell, *The 501(c)(4) Strategy*, 48 Tax Mgmt. Ests., Gifts & Trs. J. No. 1 (Jan. 12, 2023). Reproduced with permission from Tax Management Estates, Gifts, and Trusts Journal, 48 01, 1/12/23. Copyright © 2023 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com.

earnings of such entity inures to the benefit of any private shareholder or individual."[201] This private inurement language is identical to the private inurement language found in IRC § 501(c)(3) and has been construed in the same manner.

Treasury Regulation § 1.501(c)(4)-1(a)(2)(i) provides that, "[a]n organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community."

When interpreting the "primarily engaged in" requirement, many well-attuned advisors use a 60%/40% rule—60% or more of the organization's expenditures must be for activities that promote social welfare and 40% or less may be for political campaign contributions.

There is some indication, though not binding, that the IRS considers the 60%/40% rule to satisfy the "primarily engaged in" requirement. Due to a backlog of 501(c)(4) tax-exempt applications, the IRS published Fact Sheet 2013-8 in June 2013, which announced the creation of a "safe-harbor" option for certain organizations (starting with 80 groups in particular at the time that the Fact Sheet was released) that had their applications for 501(c)(4) status pending:

> This "safe-harbor" option will provide certain groups an approved determination letter granting them 501(c)(4) status within two weeks if they certify they devote *<u>60 percent</u> or more of both their spending and time on activities that promote social welfare* as defined by Section 501(c)(4). At the same time, they must certify that *political campaign intervention involves <u>40 percent</u> or less of both their spending and time.*[202]

While this Fact Sheet did not establish a binding 60%/40% rule for determination of 501(c)(4) tax-exempt status because it applied only to applicants with applications pending more than 120 days as of May 28, 2013, it does indicate that the IRS generally considers a 60%/40% split between social welfare and political activities to qualify an organization for 501(c)(4) tax-exempt status.

The promotion of social welfare includes everything under 501(c)(3) (i.e. charitable, educational, scientific, and religious activities). In addition, promoting social welfare can include other activities that promote the common good, including attempts to influence legislation (i.e. lobbying) and can also include politicizing, advertising, and propaganda. So, although the $1.6 billion donation mentioned above cannot be spent primarily on "political activity," it could be used in a way that will have a dramatic political impact. For example, the majority could be used for issue-related advertisements during a political campaign, with much of the rest being used for political campaign intervention.

a. Tax Issues

[201] Emphasis added.
[202] Emphasis added.

No charitable income tax deduction is permitted for a contribution to a 501(c)(4) organization, but some donors are motivated by the ability to transfer appreciated or income-producing assets that can be sold tax-free and used for political and charitable purposes. If someone who would give cash for political purposes can give appreciated or income-producing assets, then it would certainly make sense for them to do so. The other key tax benefit is that no income tax is triggered when an appreciated or non-leveraged income-producing asset is sold by a tax-exempt recipient. Therefore, a donor with appreciated assets that either does not need a charitable contribution deduction or wants the greater flexibility of a 501(c)(4), may want to contribute the appreciated asset or assets to a 501(c)(4) organization. Because of the assignment of income doctrine, any gift must be completed before there is a binding obligation to sell the asset or assets contributed in order to avoid having federal income tax imposed upon the donor. This works the same way with 501(c)(3) organizations.

Just like with a gift to a 501(c)(3) organization, the gift must occur before there is a binding obligation to sell in order to avoid federal income tax on the appreciation under the assignment of income deductions.

Gifts made by individuals to 501(c)(4) Social Welfare Organizations and to certain dedicated political organizations are not subject to federal gift tax, but are subject to federal estate tax for decedents who die leaving more than the amount that can pass estate-tax-free.

For this reason affluent individuals who wish to support political causes and specific candidates may form or contribute to Section 501(c)(4) Organizations, but should also take care to not retain a degree of control over such organizations that would cause the Organization's assets to be considered as owned by the donor under IRC § 2036(a)(2). This section provides that if a donor makes a gift and retains the right—even if exercisable only in conjunction with others—to direct how the asset(s) gifted may be enjoyed then the value of the gifted property is includable in the donor's gross estate.

An easy mistake to make is to set up a 501(c)(4) Organization identically to how one would set up a family foundation (for example, by making themselves the directors) and end up with a very large estate tax bill when the assets of the 501(c)(4) Organization are included in the donor's estate with no corresponding deduction. To avoid this problem, the donor must either trust a third party to run the 501(c)(4) Organization while relinquishing all control, or provide that the 501(c)(4) Organization will auto-convert on death to a 501(c)(3) so that the value of the assets held can qualify for the federal estate tax deduction under IRC § 2055.

Most forms of income earned by a Section 501(c)(4) Organization will not be subject to federal income tax, in generally the same way that applies to a Section 501(c)(3) Charitable Organization, even though a Section 501(c)(4) Social Welfare Organization may expend a significant portion of its resources on "legislative and partisan activities" in addition to lobbying.

For example, in Revenue Ruling 68-656 the IRS indicated that a Social Welfare Organization that was funded to educate the public on a "practice that is not presently legal" and to lobby in favor of legalizing the practice was exempt under Section 501(c)(4).

As another example, a radio broadcasting company was found to be exempt with respect to conducting free public radio programs to disseminate liberal and progressive social views.[203] On the other hand, there are limits to the extent that a 501(c)(4) Organization can benefit or fund a particular candidate and the exact boundaries or percentages with respect to such support has not been determined.

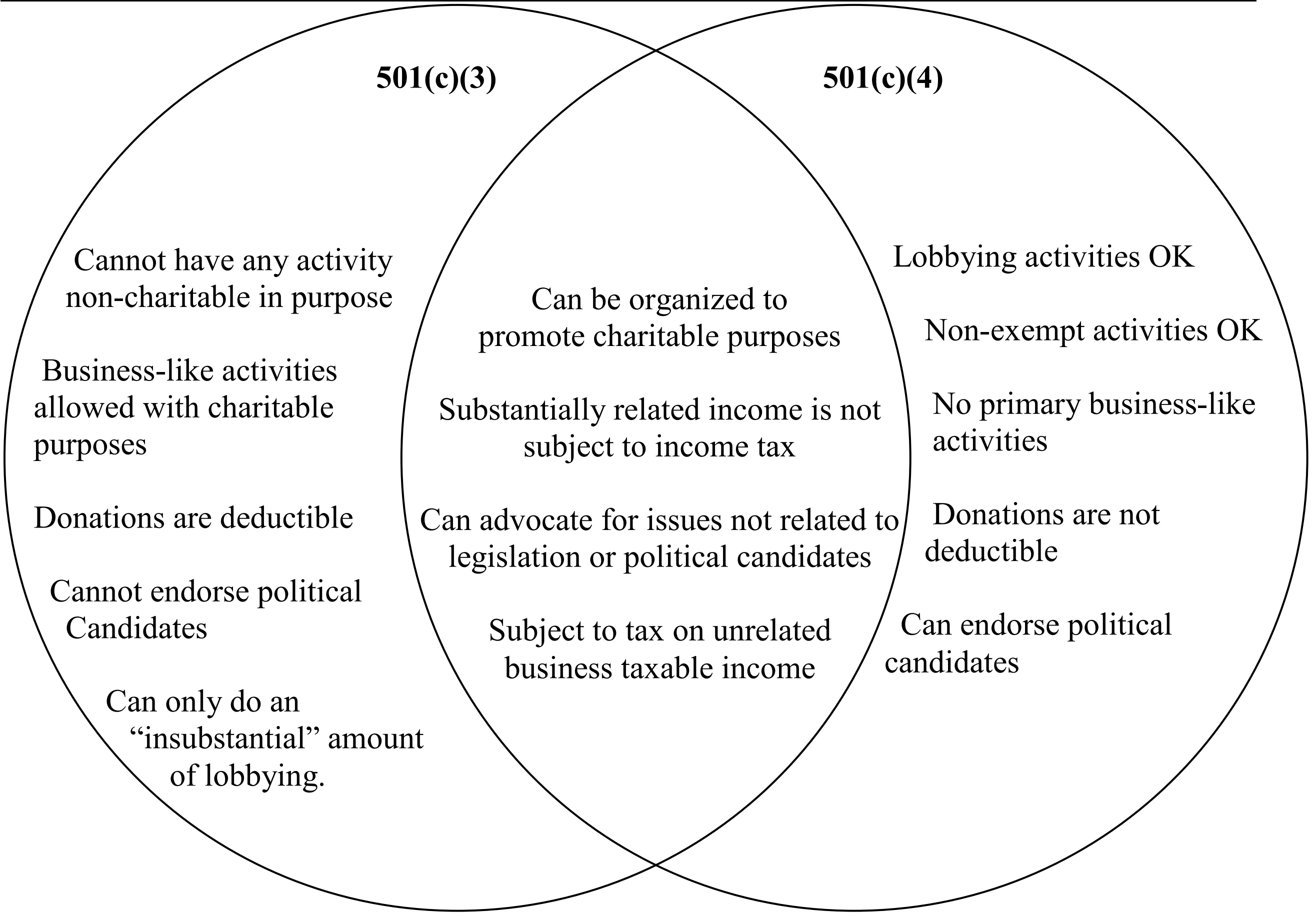
A donor who wishes to have extensive publicity and lobbying with respect to an area of political activity, such as educating the public and lobbying for or against abortion rights, school educational and communication rights and legislation, or pro- or anti-same-sex viewpoints and incidental support of political parties and politicians associated therewith may work well under a Section 501(c)(4) Organization.

One final word of caution to philanthropists looking to move the family business out of the estate (assuming they solve the § 2036 problem): a 501(c)(4) Organization cannot be a holding company with the occasional political donation. A 501(c)(4) must have social welfare activities that are commensurate in scope with its assets. Therefore, while a 501(c)(4) does not have a "minimum distribution requirement" like a 501(c)(3) private foundation, the 501(c)(4) Organization does need a plan to use the assets or income for 501(c)(4) purposes in a meaningful way.

b. Comparisons to Other Organizations

Although both 501(c)(4) and 501(c)(3) organizations can be organized to promote social welfare, there are several important differences between the two types of organizations, as illustrated by the following diagram:

[203] *DEBS Memorial Radio Fund, Inc. V. Commr'*, 148 F. 2d 948 (2nd Cir. 1945).



While 501(c)(3) organizations are divided into public charities and private foundations, with most organizations receiving their funds from a single philanthropy falling into the more regulated private foundation category, there is no similar category for 501(c)(4) organizations. As a result, 501(c)(4) Organizations are not subject to the excess business holding rules or self-dealing rules. Like public charities under 501(c)(3), however, they are still subject to the excess benefit transaction rules under IRC § 4958, which will prevent individuals and entities associated with a 501(c)(4) organization from receiving any substantial direct or indirect economic benefit. The following charts illustrate the rules and excise taxes that apply to private foundations, public charities, and 501(c)(4) organizations:

	Private Foundation	**Public Charity**	**501(c)(4) Organization**
UBTI	Subject to Excise Tax	Subject to Excise Tax	Subject to Excise Tax
Self-Dealing	Prohibited	*Not* Prohibited	*Not* Prohibited
Excess Business Holdings	Subject to Excise Tax	*Not* Subject to Excise Tax	*Not* Subject to Excise Tax
Excess Benefit Transactions	*Not* Subject to Excise Tax	Subject to Excise Tax	Subject to Excise Tax

Operational Flexibility

- Needs to operate exclusively for charitable, educational, religious, or scientific purposes (no other *significant* purpose)
- 5% minimum distribution requirement
- Cannot hold more than 20% of active trade or business (subject to exceptions)
- Stricter set of investment criteria (4944)
- Cannot (a) lobby, (b) grant to non-public-charities except with ER, (c) no partisan candidate activity.

Disqualified Persons
(e.g. the funder)

- VERY STRICT SELF-DEALING RULES
- No excessive private benefit
- No inurement

Private Foundation

Requirements to Qualify

None – other than general 501(c)(3) or and operating test. PF is the default status for a 501(c)(3)

Tax Rules

- LESS favorable contribution deduction rules for gifts for income tax
- Contributions deductible for estate and gift tax
- **EXCEPT FOR 1.39% NII**, does not pay tax on income that is sufficiently **related** to charitable purposes (e.g. tuition, admission, etc.)
- **EXCEPT FOR 1.39% NII**, generally does not pay tax on passive income, except:
  - Debt-financed income
  - S-corporation income
  - Certain income from controlled subsidiary

Operational Flexibility

- Needs to operate exclusively for social welfare activity (charity + other activities for public good).
- No set distribution requirement – just needs operations 'commensurate in scope' to assets.
- Needs to invest prudently under state law, but no PF rules.
- Can do unlimited lobbying
- Can do SOME candidate activity.

Disqualified Persons
(e.g. the funder)

- FMV transactions only
- No excessive private benefit
- No inurement

501(c)(4) Social Welfare Organization

Requirements to Qualify

Just needs to be organized and operated for 501(c)(4) purposes.

Tax Rules

- NO charitable contribution deduction.
- Contributions deductible for gift tax BUT NOT estate tax.
- Does not pay tax on income that is sufficiently **related** to charitable purposes (e.g. tuition, admission, etc.).
- Generally, does not pay tax on passive income, except:
  - Debt-financed income
  - S-corporation income
  - Certain income from controlled subsidiary
- Proxy tax on investment income used to lobby, if from member contributions

It is also important to differentiate a 501(c)(4) Organization from a Section 527 Political Organization. Section 527 Political Organizations can directly benefit any one or more candidates or engage in any political activity that is legal, but will be subject to income tax on investment income in the same way that applies to a corporation (presently at the 21% tax bracket on net income). This is referred to in Section 527(b) as "political organization taxable income" and is defined as "gross income, other than 'exempt function income,' minus deductions that are directly connected with the production of such includable gross income." The "exempt function income" that is not considered to be taxable includes amounts received as (1) contributions of money or property from donors, (2) membership dues, (3) the proceeds from certain bingo games described in IRC § 513(f)(2), and (4) proceeds from political fundraising or entertainment events or the sale of political campaign materials "other than amounts received in the ordinary course of a trade or business" as defined in IRC § 527(c)(3). Extensive rules exist for the separate accounts and accounting necessary to qualify fundraising, entertainment, and sale of political campaign materials as being non-taxable as opposed to having been "received in the ordinary course of a trade or business."[204]

c. Summary

The following attributes of 501(c)(4) organizations create planning opportunities for political and charitable giving:

- No income tax deduction for funding. While a taxpayer cannot receive an income tax deduction for what is contributed to a 501(c)(4), an income producing or appreciated asset can be placed into the 501(c)(4), and the 501(c)(4) can then receive the income from the asset or sell the asset and never pay tax.

  For example, a taxpayer receiving $10,000 a month from an oil and gas interest must pay $3,700 a year in income taxes and is left with $6,300 for donations to political parties.

  On the other hand, if the taxpayer puts the oil and gas interest into a 501(c)(4), he or she will pay no income taxes and the 401(c)(4) can directly donate the $10,000 of income each month to political causes.

- Contributions to a 501(c)(4) organization are not subject to gift tax for transfers made after December 18, 2015, and therefore such transfer does not count against the $12,060,000 exemption.

- Contributions to a 501(c)(4) organization may qualify for an estate tax deduction if the following strategies are employed.

    - If the donor controls the 501(c)(4) organization, it will be in his estate when he dies under IRC § 2036(a)(2). However, the 501(c)(4) organization can

[204] It is noteworthy that the purchase of meals for campaign staff and the payment of financial benefits and assets to individuals can be taxable to those individuals.

provide that upon the death of the donor, it will go to a 501(c)(3) organization and therefore the donor would receive an estate tax deduction.

- Alternatively, the donor could donate to a 501(c)(4) organization that he does not control, or he could give up control more than 3 years before his death because IRC § 2036(a)(2) includes a 3-year lookback provision.

- The income of the 501(c)(4) is not subject to income tax, except for the tax imposed upon unrelated business taxable income ("UBTI").
- 501(c)(4) organizations can enter into many transactions and hold many investments that are not permitted for a Private Foundation because 501(c)(4) organizations are not subject to self-dealing or excess business holdings rules.
- A 501(c)(4) organization can support political causes, lobbying, and PACs (Political Action Committees). 501(c)(3) organizations cannot engage in any partisan candidate activity and are severely limited to the amount of legislative lobbying.
- A 501(c)(4) may own all of the voting stock of an operating or investment company, with non-voting stock being held by a Private Foundation or Public Charity—a disqualified person can control the 501(c)(4) and control the company, in a fiduciary manner, while avoiding self-dealing and excess business holdings rules.

Special thank you to Karl Mill for allowing us to use his slides.

20. <u>Bargain Sales</u>

The authors thank Professor Jerry Hesch for the examples set forth below, and for the great example he sets for all of us.

Oftentimes, individuals have properties that are worth more than what available buyers are willing to pay.

While the value of any given property is what a willing buyer would pay a willing seller in an open marketplace, economic circumstances often leave a would-be seller with the choice of keeping a property or selling it for less than what a willing buyer would pay a willing seller in an open marketplace.

When this occurs and a charity is willing to purchase the property, the seller can give the charity a "bargain purchase price." This provides the seller with the benefit of knowing that the property will benefit the charity and that the seller will receive an income tax deduction equal to the excess of (1) the fair market value at the time of sale, over (2) the net proceeds from the sale.

While this is generally equivalent to making an outright donation to the charity of a portion of the property, certain rules and practices will apply.

a. There should be a contemporaneous appraisal or recent appraisal of the property, and a recognition/appreciation by the charity of the bargain sale.

b. For a deduction to be allowed for any donation of $250 or more, the charity must give a contemporaneous written acknowledgment of the gift pursuant to IRC § 170(f)(8), which requires that such acknowledgment include the following:

i. The amount of cash and a description (but not value) of any property other than cash contributed;

ii. A statement of whether the charity provided any goods or services in consideration, in whole or in part, for any such cash or property; and

iii. A description and good faith estimate of the value of any such goods or services or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.

An acknowledgment will be considered to be contemporaneous if the taxpayer obtains the acknowledgment on or before the earlier of—

- The date on which the taxpayer files a return for the taxable year in which the contribution was made, or

- The due date (including extensions) for filing such return.

Example 1: An investor owns property appraised for $2 million but finds that he can only find a buyer who is willing to pay $1.2 million. The investor then decides to sell the property to a charity for $1 million and take a $1 million charitable deduction for the remaining value. If the property still had debt of $800,000, then $400,000 of the mortgage is subtracted from the $1 million that the charity paid for the property, resulting in a $600,000 capital gain. The remaining $400,000 of debt is subtracted from the $1 million tax deduction to equal a charitable tax deduction of $600,000.

Appraisal Value	**$2,000,000**
Sold to Charity for	**$1,000,000**
Gross Receipts	**$2,000,000 - $1,000,000 = $1,000,000**
Capital Gain Portion (½)	**$1,000,000 - $400,000 = $600,000**
Charitable Portion (½)	**$1,000,000 - $400,000 = $600,000**

Example 2: An investor owns property appraised for $1.5 million but finds that he can only find a buyer who is willing to pay $800,000. The investor then decides to sell the property to a charity for $1 million and take a $1 million charitable deduction for the remaining value. If the property still had debt of $600,000 and one-third of the debt is

allocated to the charitable portion and two-thirds is allocated to the sale, then $400,000 of the mortgage is subtracted from the $1 million that the charity paid for the property, resulting in a $600,000 capital gain. The remaining $200,000 of debt in subtracted from the $1 million dollar tax deduction to equal a charitable tax deduction of $800,000.

Appraisal Value	**$1,500,000**
Sold to Charity for	**$1,000,000**
Gross Receipts	**$1,500,000 - $1,000,000 = $500,000**
Capital Gain Portion (2/3rds)	**$1,000,000 - $400,000 = $600,000**
Charitable Portion (1/3rd)	**$1,000,000 - $200,000 = $800,000**

21. Techniques To Transfer Properties Out of Private Foundations Into A For-Profit Master Holding Company Without Committing An Act Of Self-Dealing

Consider a situation in which a Disqualified Person's charitable Foundations own varying interests in LLCs. The LLCs own properties and the Disqualified Person wishes to transfer these LLCs and their properties out of the foundations and into a Master Holding Company, which will own all of his personal properties.

In the situation where person A has been a partner with their Private Foundation for a few years. Person A, on their own, formed a partnership with the Private Foundation in the form of an LLC. They want to buy out the Private foundation, liquidate the LLC, and distribute its investments pro rata. How do the self-dealing rules apply?

Depending on how much of the profit Interest in the LLC is owned by disqualified persons (including person A), one of two methods applies. First, if person A owns exactly 35% of the profit interest in the LLC, then the LLC is not a disqualified person, and buying out the Foundation and liquidating the LLC should not be a problem. Person A would still be very close to triggering an act of self-dealing. The co-investment with disqualified persons is not self-dealing as long as the foundation is not invested in a disqualified person. Regardless. It makes sense to extricate the foundation by having a non-disqualified person buy it out or by having the LLC dissolve.

If person A has more than 35% of the profit interest in the LLC, then it is important to proceed cautiously. In this case, any transaction between the LLC and the foundation is an act of self-dealing unless an exception applies. Just dissolving could be an act of self-dealing. A corporate redemption exception exists for this case but only applies to corporations, not partnerships. The IRS has applied it in a partnership setting, however, so it may be a path out, but it would be best for person A to proceed cautiously to ensure that IRC 4941(d)(2)(f) is satisfied.

Regardless, sophisticated foundations will have foundations and family members invest in the same funds. The Foundation needs to be closely monitored to avoid any instances of self-dealing. If person A wants to keep a co-investment in the process, they should get a primer on the rules and what needs to be kept in mind and be committed to always staying at or below 35%.

The self-dealing rules do not permit the holding company to be owned by both the Disqualified Person and the foundations. The options discussed below are potential techniques to allow the LLCs to be transferred into the holding company without committing an act of self-dealing in the process.

a. Redemption

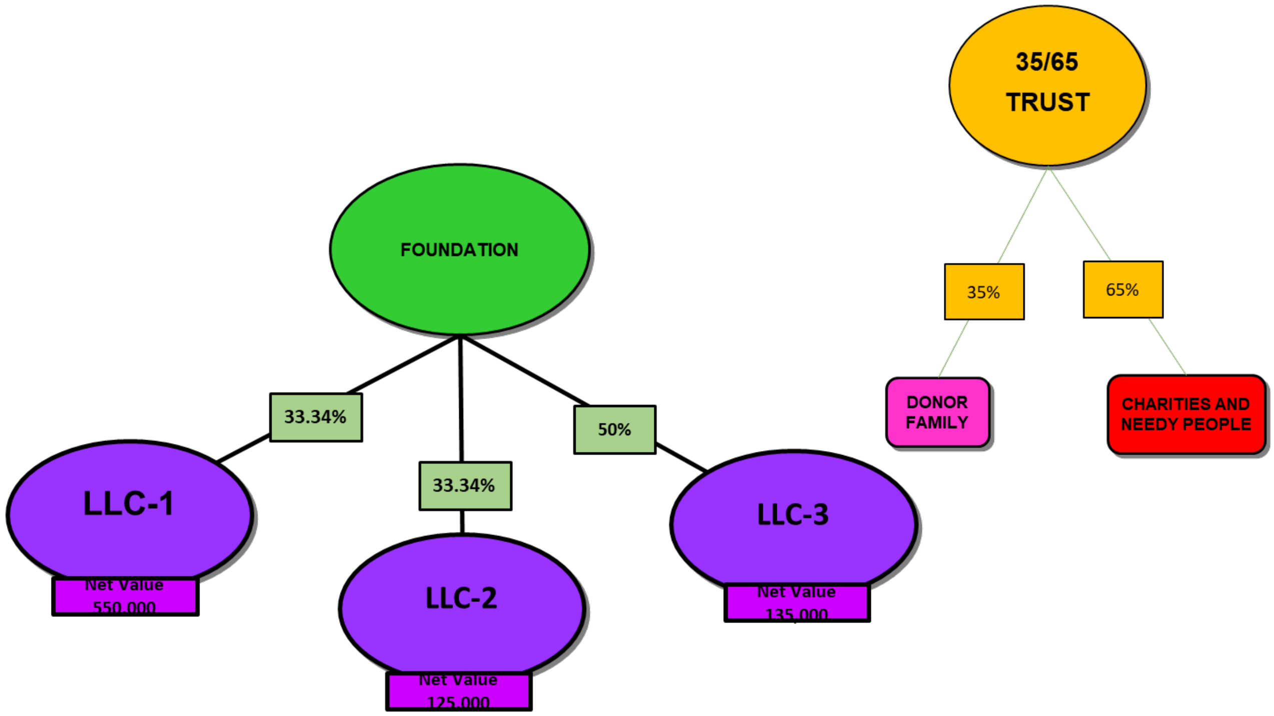
I.R.C. § 4941(d)(2)(F) permits a redemption between a Private Foundation and a corporation that may be owned in part by a Disqualified Person if:

> a."[A]ll of the securities of the same class as that held by the foundation are subject to the same terms" and
>
> b. "[S]uch terms provide for receipt by the foundation of no less than fair market value."

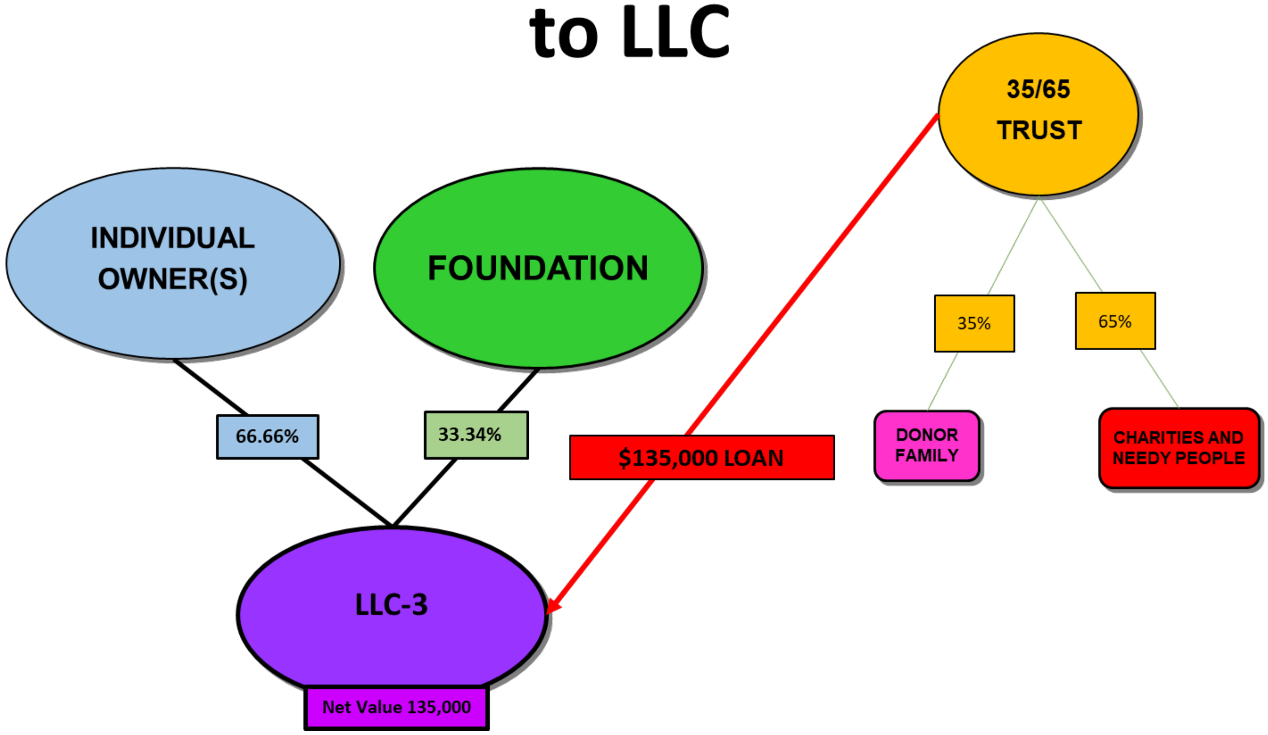
The exception involves "a Private Foundation and a corporation which is a Disqualified Person." The code does not provide for a redemption between a Private Foundation and an entity taxed as a partnership. However, the IRS has permitted the redemption of a partnership interest under the same 4941(d)(2)(F) requirements as a corporate redemption, although there does not appear to be statutory support for this generous result.[205]

[205] I.R.S. Priv. Ltr. Rul. 9237032 (June 16, 1992).

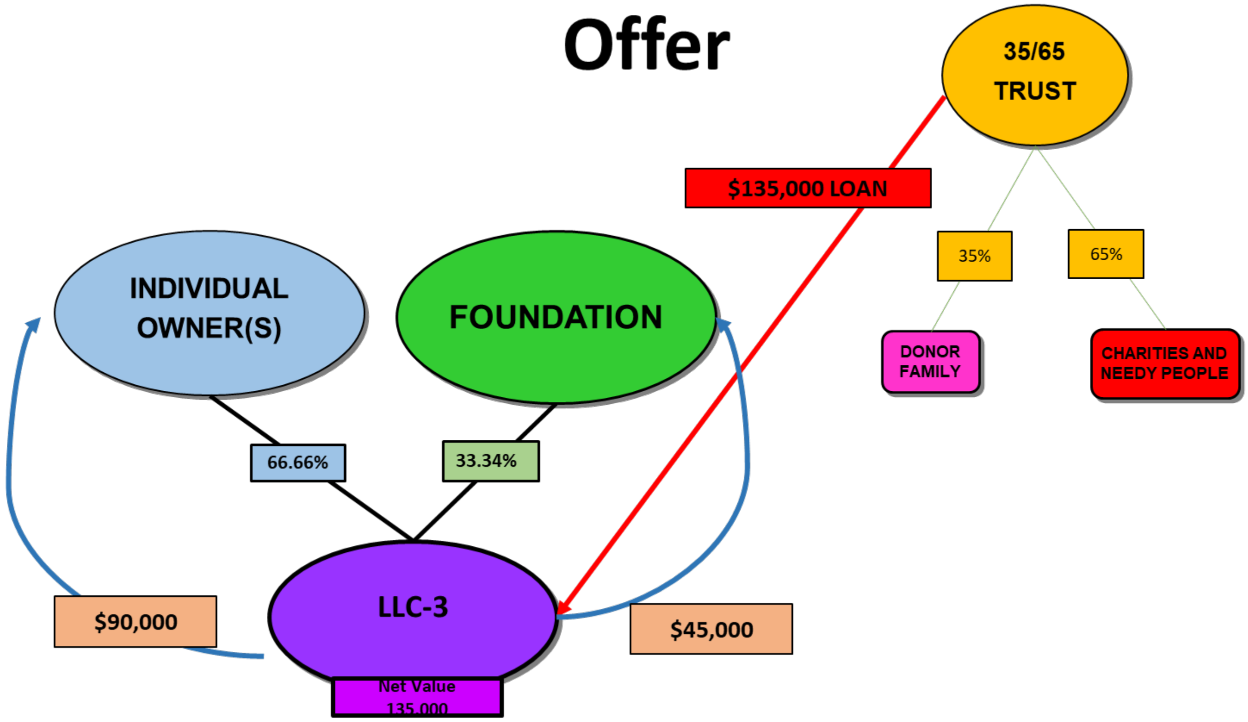
Step 1: Form 35/65 Trust



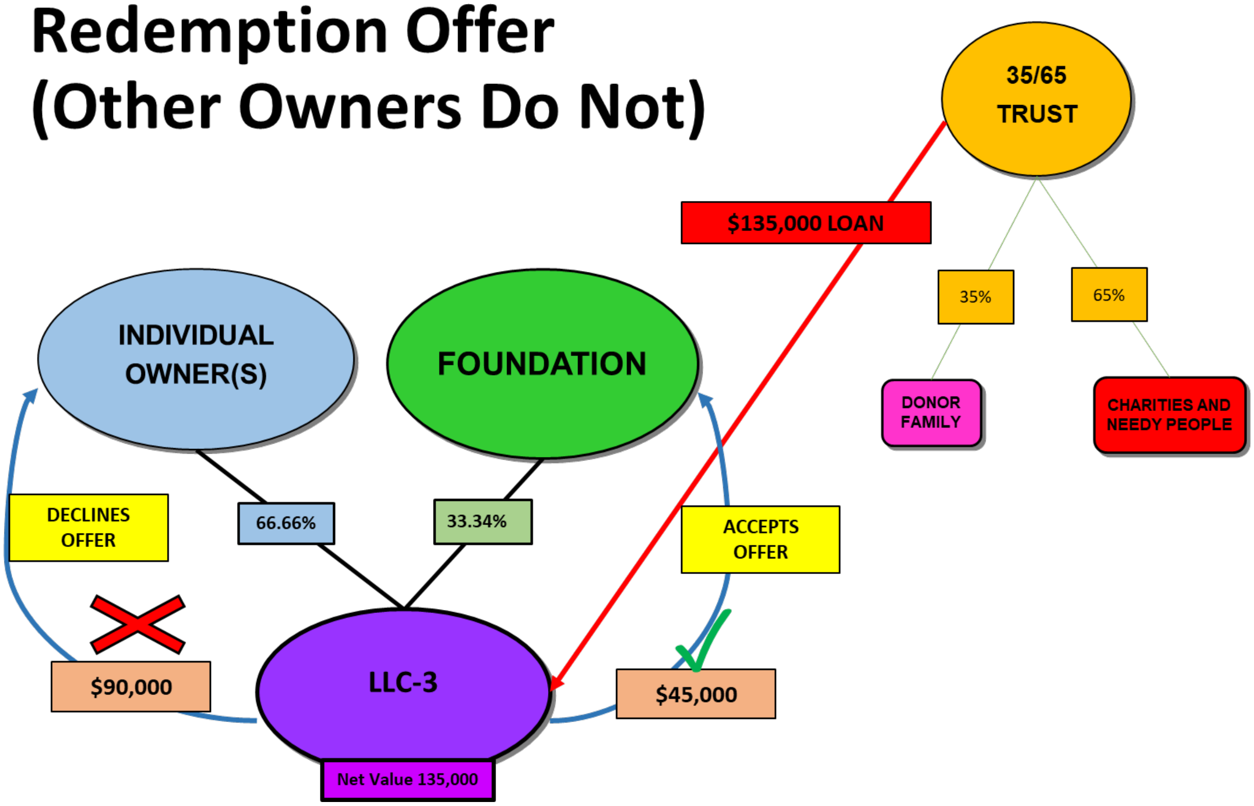
Step 2: 35/65 Trust Makes Loan to LLC



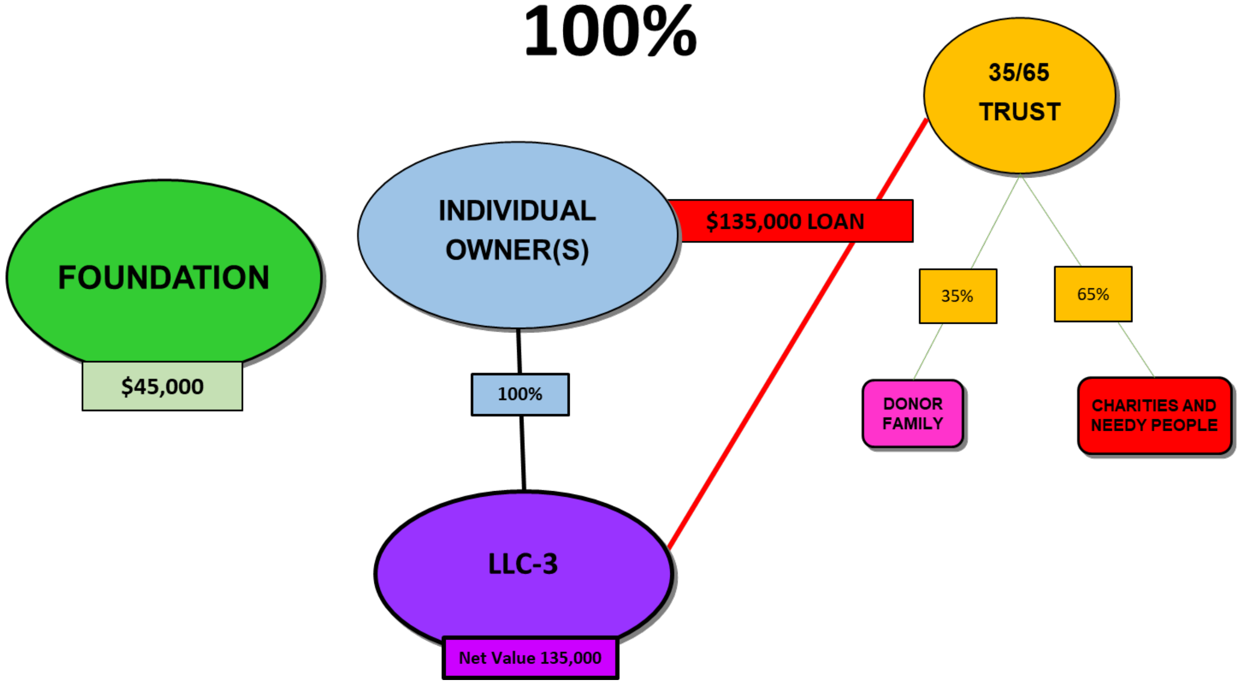
Step 3: LLCs Make Redemption Offer



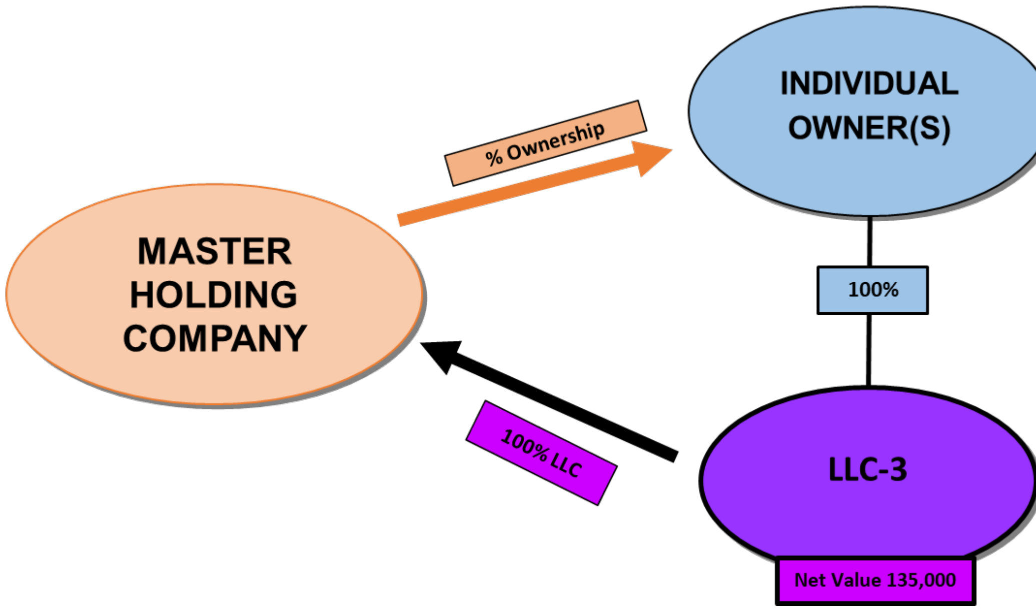
Step 4: Foundation Accepts Redemption Offer (Other Owners Do Not)

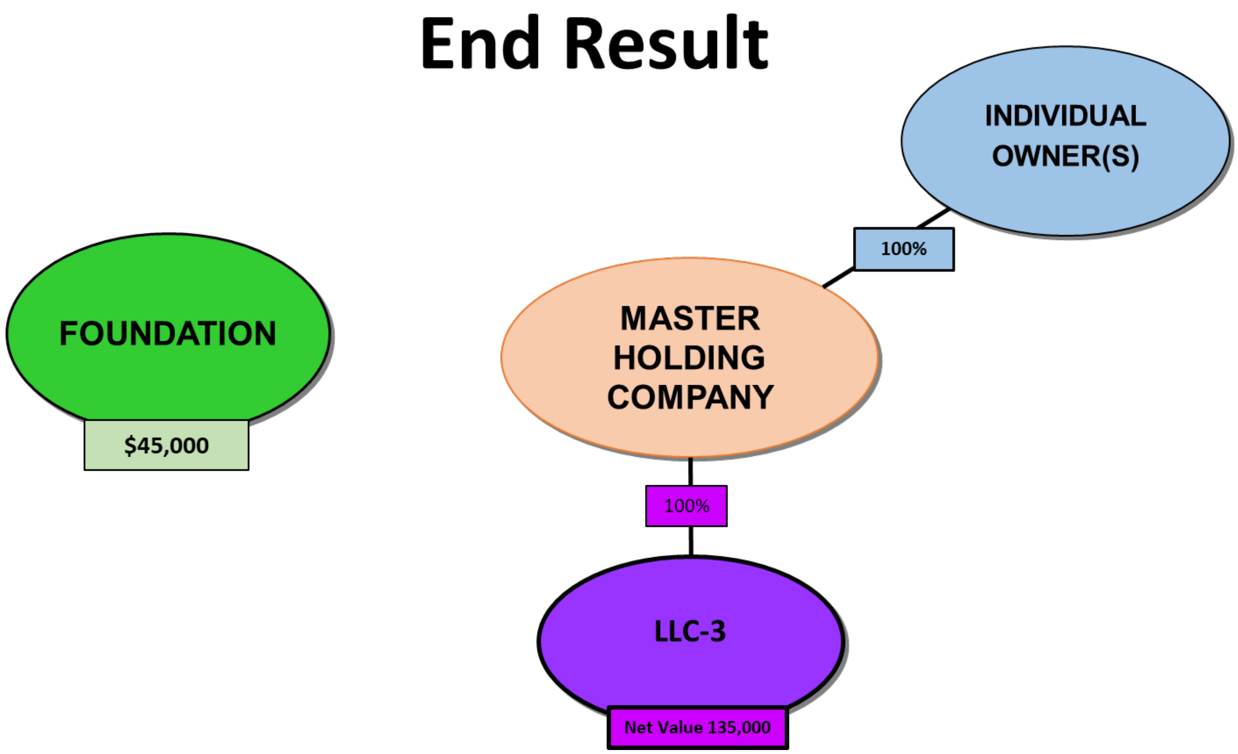


Step 5: Individual Owner(s) Own 100%



Step 6: Owners May Transfer LLC Interests to Master Holding Company Owned in Part by Disqualified Persons





b. Sale to 35/65 Trust

Under this technique, the Disqualified Person will form and fund a new trust in which the Disqualified Person's family members are up to 35% beneficiaries of the trust and charities and people in need are 65% beneficiaries of the trust (see Chapter 4 for further discussion of 35/65 Trusts). The 35/65 Trust will be immune from the self-dealing rules, even though a Disqualified Person is the grantor of the trust, because Disqualified Persons must have a greater than 35% beneficial interest for a trust to be considered a Disqualified Person.[206] The Disqualified Person or someone he or she trusts will be the trustee of the trust.

The Disqualified Person can fund the 35/65 Trust and the trust can purchase the foundations' interests in the LLCs. The 35/65 Trust will then transfer its interests in the LLCs to the Master Holding Company in exchange for an interest in the Master Holding Company.

Trusts that qualify as split-interest trusts under IRC § 4947 are subject to the self-dealing rules under IRC § 4941. Therefore, if the 35/65 Trust established in the scenarios above qualifies as a split-interest trust, the above techniques could constitute acts of self-dealing.

A split-interest trust is a trust that meets all 3 of the following requirements under IRC § 4947(a)(2):

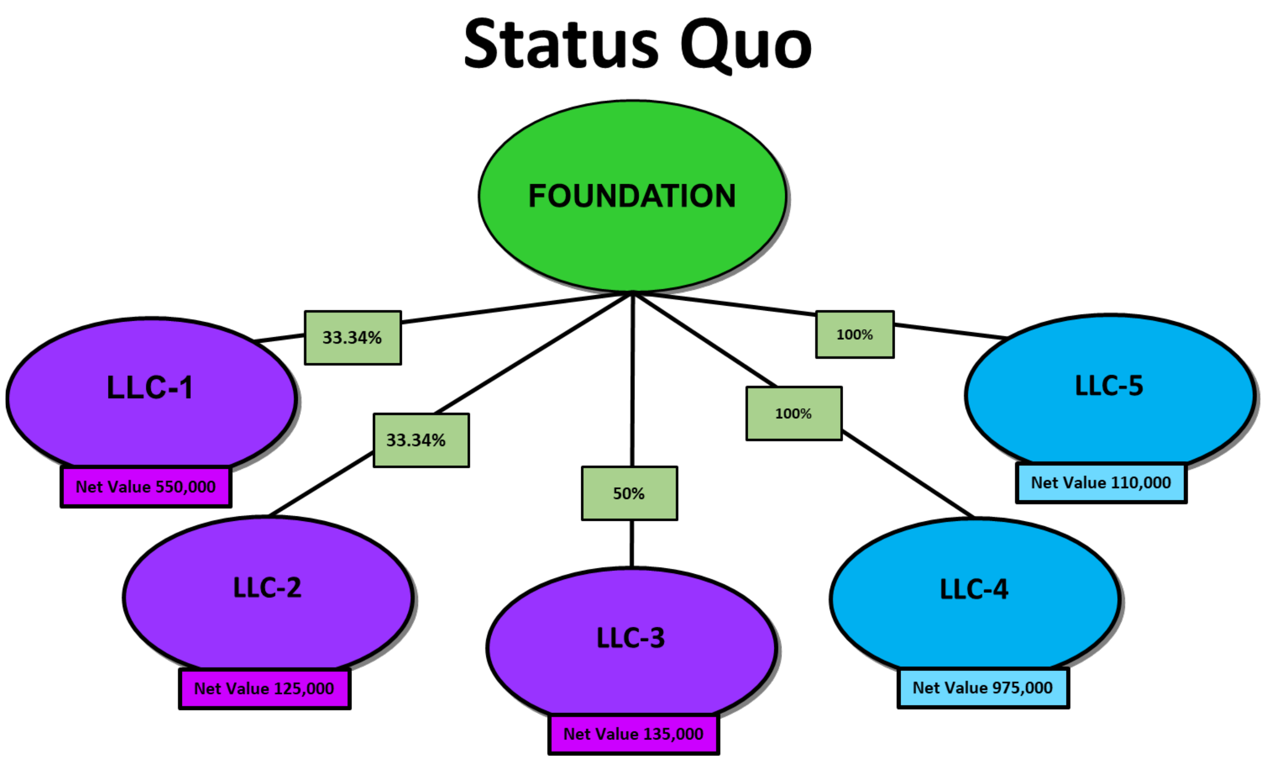
1. "[I]s not exempt from tax under section 501(a),"

[206] I.R.C. § 4946 (a)(1)(g).

2. "[N]ot all of the unexpired interests in which are devoted to" "religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals,"[207] and

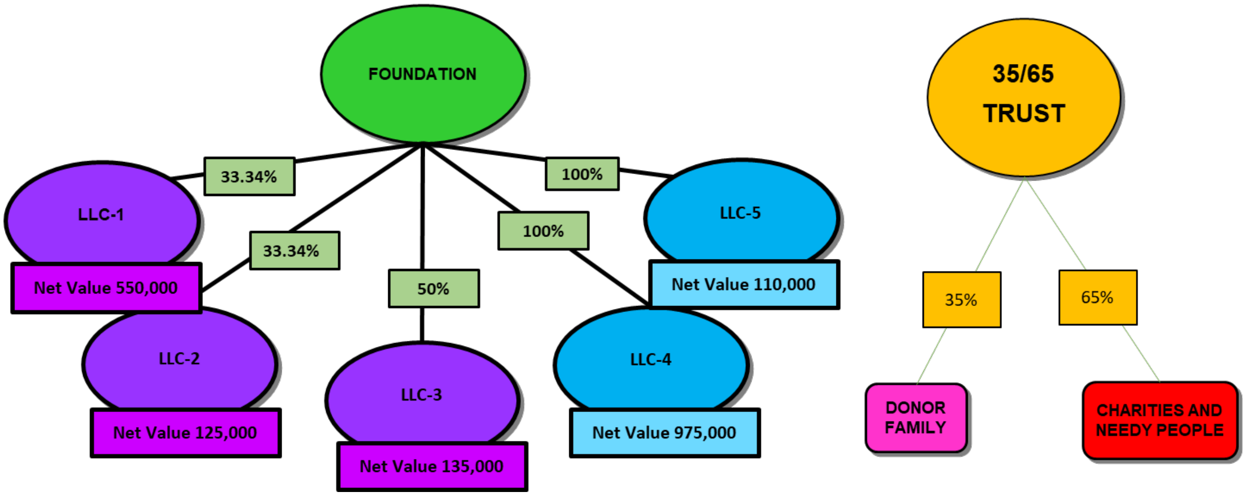
3. "[H]as amounts in trust for which a [charitable] deduction was allowed."

Generally, three types of trusts meet these requirements: charity remainder annuity trusts, charitable remainder unitrusts, and pooled income funds.

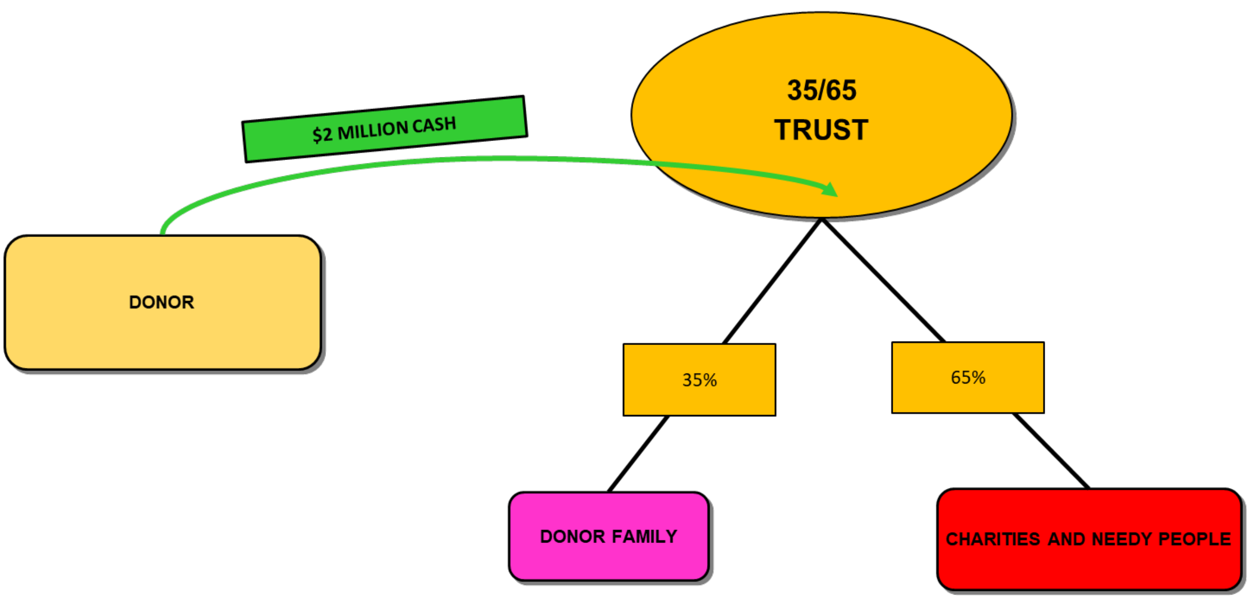


[207] I.R.C. § 170(c)(2)(B).

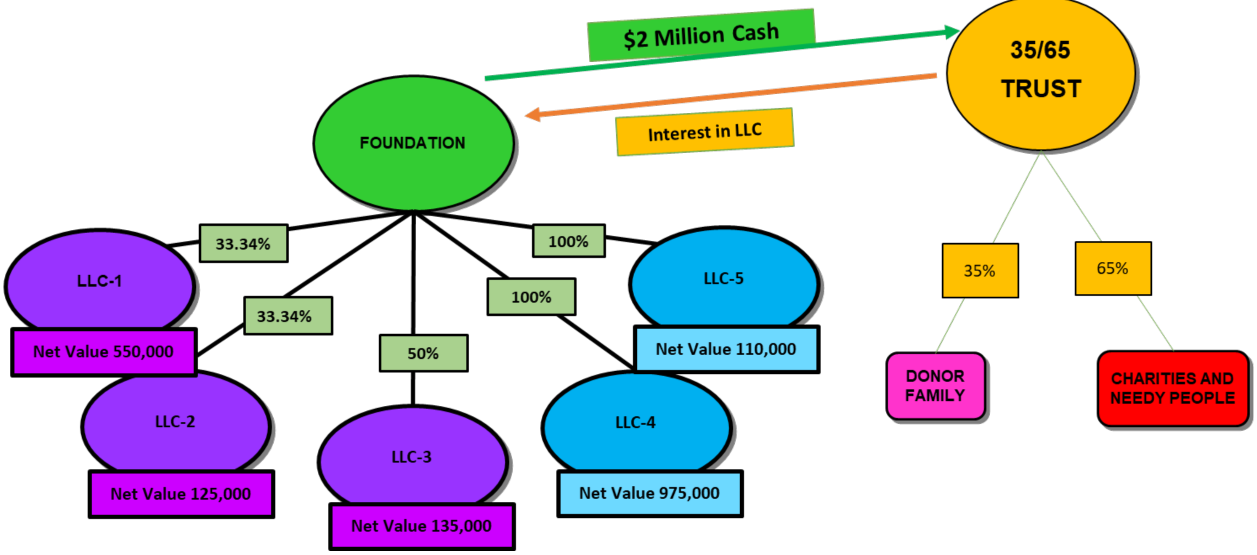
Step 1: Form 35/65 Trust



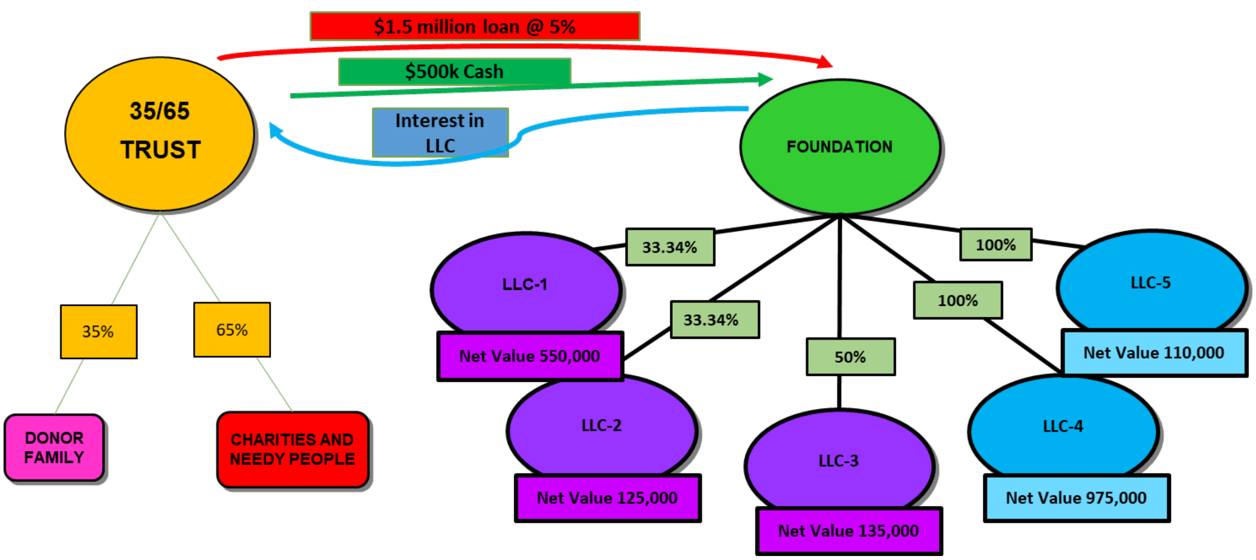
Step 2: Fund 35/65 Trust



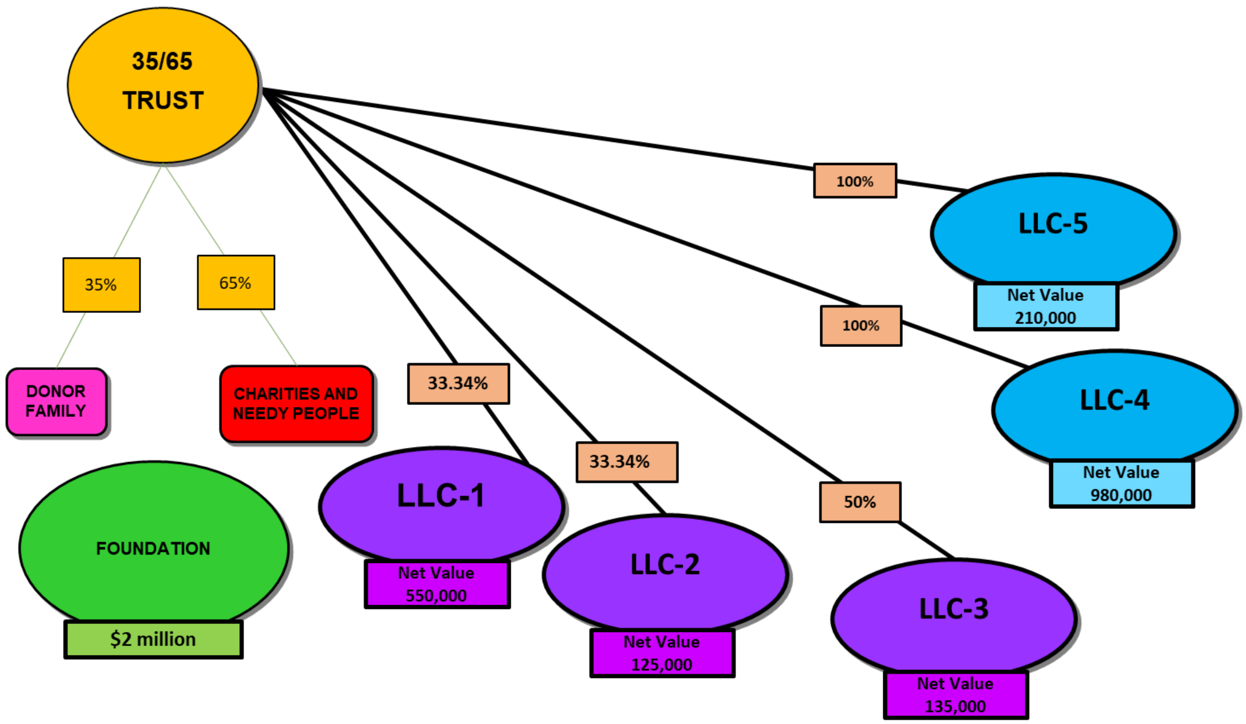
Step 3a: Trust Purchases LLC Without Debt



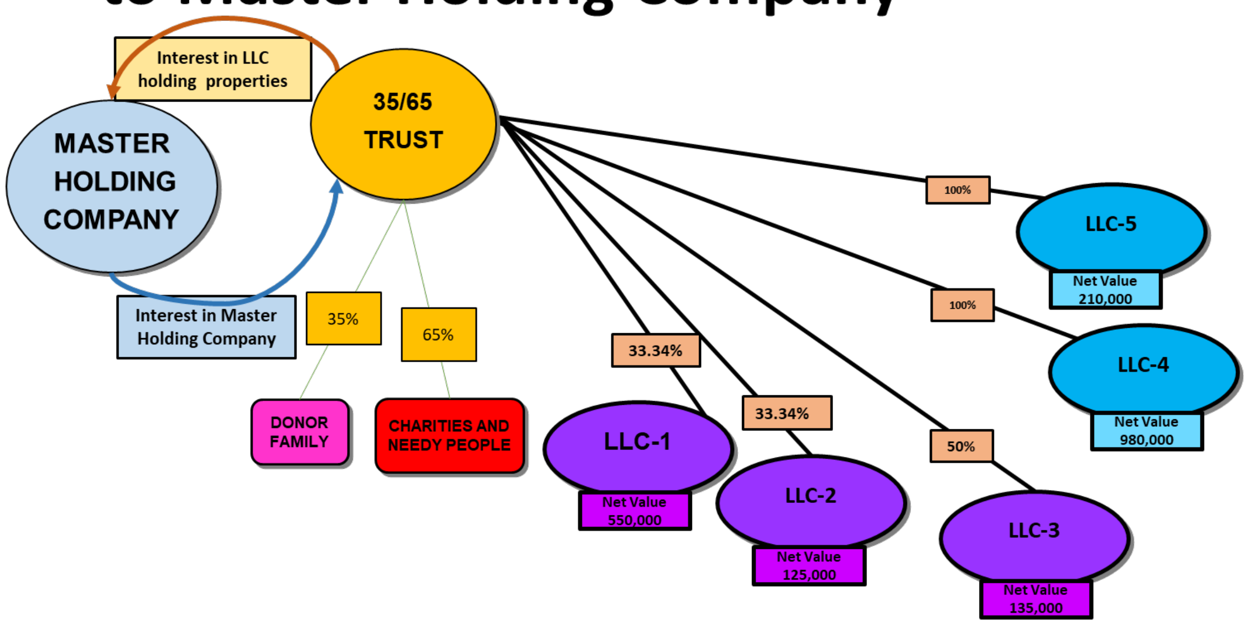
Step 3b: Trust Purchases LLC With Debt

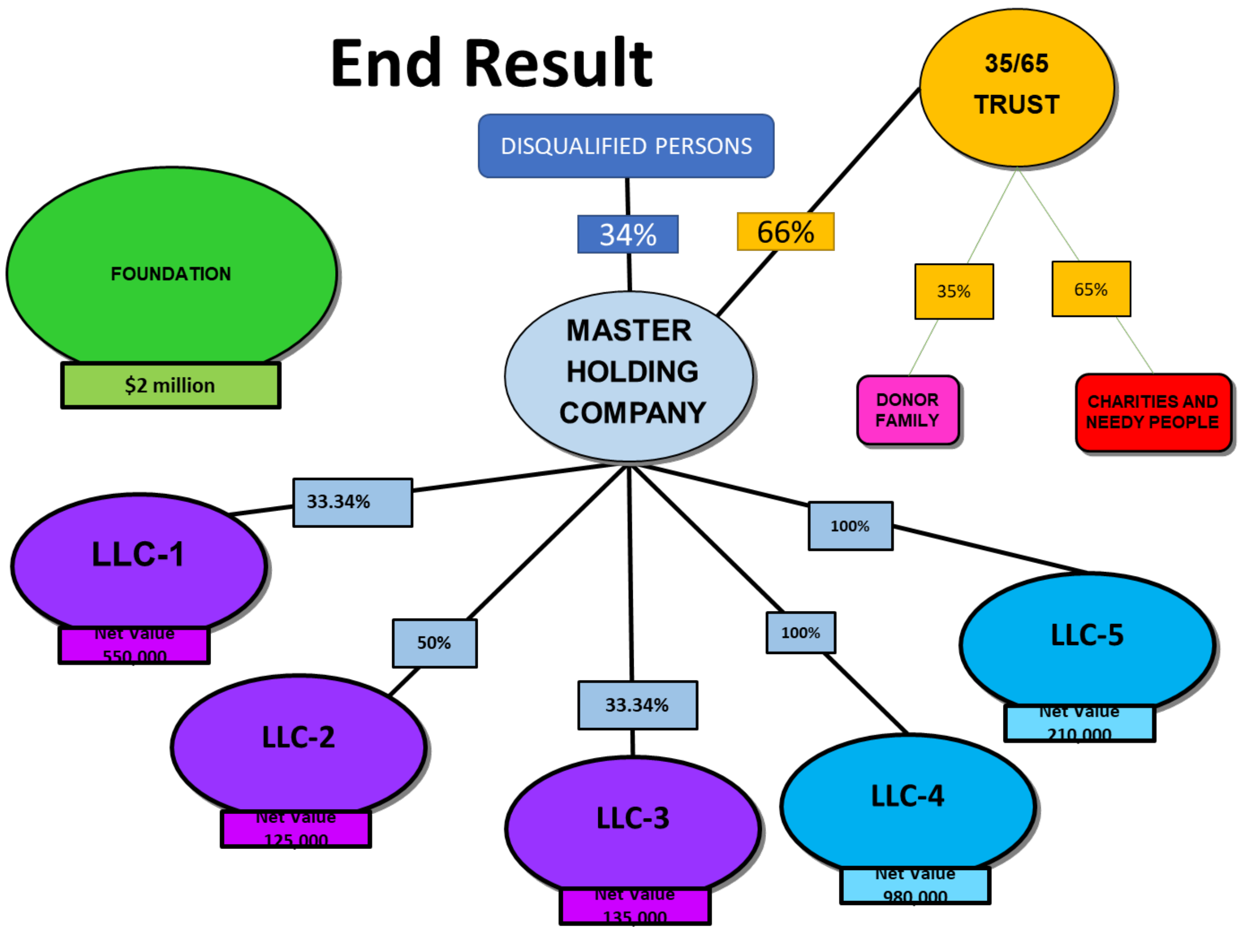


Step 4: Trust Owns LLC Interests



Step 5: Trust May Transfer Interests to Master Holding Company





22. <u>How to Write Off Your Cake, Antiques, Artwork, and Other Tangible Personal Property with Control</u>

IRC § 170 permits a deduction for charitable contributions to a Private Operating Foundation.[208] Donations of tangible personal property, including antiques and artwork, qualify for a deduction under § 170 if the donor has relinquished dominion and control over the personal property.[209] The deduction is the fair market value[210] of the donated property, reduced according to the provisions in § 170(e) if the property is worth more than its income tax basis and the organization does not use the property in a use related to its exempt function.

a. What Qualifies as Related Use

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[208] I.R.C. §§ 170(b)(1)(A)(vii), 170(b)(1)(F).
[209] Kirschten and Freitag, *C. Definition of Money or Property*, *in* 863-3rd T.M., Charitable Contributions: Income Tax Aspects.
[210] Generally, fair market value is "the price at which the property would change hands between a willing buyer and a willing seller, neiher being under any compulsion to buy or sell and both having reasonable knowledge or relevant facts." Treas. Reg. § 1.170A-1(c)(2) (as amended in 2020).

Donated tangible personal property must be related to the purpose or function of the charitable organization or else the deduction will be limited to the donor's basis in the property.[211]

For example, a taxpayer received a fair market value deduction under § 170 for Yiddish sheet music donated to the National Yiddish Book Center—an organization that uses the Yiddish sheet music directly for its charitable purpose.[212]

In addition, the tangible personal property must actually be used by the charity for a purpose related to the organization's charitable purpose, and not simply stored for future use or sale. This is why there are so many jewelry and artwork displays at universities and hospitals. If the intent of the donation is to enable the charity to sell the artwork to have money, and the artwork is not displayed or otherwise used in the activity of a charity, then the donor's deduction will be limited to his basis in the property.

While there is no bright-line test for how many years artwork should be actively used by a charity that receives it (or other charities with the consent of the Donee Charity) or placed on loan for active use in furtherance of its tax-exempt purpose, there is a three-year rule that requires a charity to report the sale of donated property that occurs within three years of the receipt of the donation. This causes an increased audit risk, and a resulting rule of thumb that a charity that receives a donation of artwork should use it actively in the charity for at least three years before selling it. Donation agreements commonly require a charity to use the artwork for at least three years before selling it.

For purposes of receiving the deduction, it is sufficient to contribute the tangible personal property to be displayed in a museum operated by a Private Operating Foundation. For example, taxpayers have received deductions for the fair market value of gems,[213] lithographs,[214] pre-Columbian art,[215] and paintings[216] contributed for display in museums.

A Private Operating Foundation can operate a museum so long as it meets the charitable purpose expenditure requirements under IRC § 4942(j)(3). The Private Operating Foundation must "make[] qualifying distributions . . . directly for the active conduct of the activities constituting [it] purpose or function . . . equal to . . . the lesser of its adjusted net income . . . or its minimum investment return; and substantially more than half [the foundation's] assets are devoted directly to such activities . . . ." This rule ensures that the foundation's funds are actually used to advance its educational purpose through the operation of the museum or through similar educational expenditures.

Furthermore, the museum must provide public access in order to accomplish its educational purpose. While this certainly includes being open to the public, to avoid the IRS considering the museum to be for the private benefit of the donor, the museum should be physically situated in a

[211] I.R.C. § 170(e)(1)(B)(i).
[212] *Rimmer v. Commissioner*, 69 T.C.M. (CCH) 2620 (1995).
[213] Rev. Rul. 80-69, 1980-1 C.B. 55.
[214] *Lio v. Commissioner*, 85 T.C. 56 (1985).
[215] *Ferrari v. Commissioner*, 58 T.C.M. (CCH) 221 (1989).
[216] *Silverman v. Commissioner*, 27 T.C.M. (CCH) 1066 (1968).

location that allows public access (preferably away from the donor's home and office) and be open frequently enough and with sufficient advertising to serve a public educational benefit.[217]

One way a Private Operating Foundation can act with respect to its educational purpose and allow public access is by lending items. For example, the Broad Art Foundation in California operates a lending library of artwork that it loans to museums and galleries.[218]

The following are examples of the types of donations that are and are not considered related to the charitable purpose of the charitable organization:

Examples of related use:

- Lithographs to a camp for handicapped children, with instruction in art appreciation;[219]

- Porcelain art collection to a public charity operating retirement center with purpose of creating living environment;[220]

- Stamp collection to a college with course in engraving skills;[221]

- Manuscripts to a University;[222]

- Paintings to a Jewish Community Center;[223]

- Seeds, chemicals, greenhouses, plants, livestock, animal semen, breeding equipment, transportation equipment, maintenance equipment, beds, desks, tilling equipment, riding equipment, and cafeteria equipment to private school that emphasizes science with a plant science curriculum and an animal science curriculum;[224]

- Violin to charitable organization that maintains an instrument bank and makes them available to students and other musicians in need of an instrument, on a temporary loan basis;[225]

- Watercolor paintings to educational organization for use in its art and art appreciation courses, which are a part of its curriculum, and to display, from time to time,

[217] Minnigh and Stutzman, *F. Charitable Planning*, *in* 815-3rd T.M., *Planning for Authors, Musicians, Artists, and Collectors*.
[218] https://www.thebroad.org/about/broad-art-foundation.
[219] Priv. Ltr. Rul. 77-51-044 (Sept. 22, 1977).
[220] Priv. Ltr. Rul. 81-43-029 (July 29, 1981).
[221] Priv. Ltr. Rul. 82-08-059 (Nov. 25, 1981).
[222] Priv. Ltr. Rul. 84-39-005 (June 20, 1984).
[223] Priv. Ltr. Rul. 98-33-011 (Aug. 14, 1998).
[224] Priv. Ltr. Rul. 9131052 (May 8, 1991).
[225] Priv. Ltr. Rul. 9147049 (Aug. 21, 1991).

in various other locations throughout its buildings for the general art appreciation and enjoyment of its student body and visitors;[226]

• Houseboat to marriage and family retreat and community center to serve as the initial retreat center as both a meeting place and lodging facility until permanent facilities can be built;[227]

• Porcelain art objects to non-profit retirement center to display on the wall of the residents' dining hall;[228]

• Replica of a World War II aircraft to charitable organization for exhibition and teaching purposes;[229] and

• Civil War artifacts to charitable organization that will construct a facility to store and display the items because the organization does not presently have the space to display the items. Until the organization has adequate space, the donor will display the items in his home. The public will have access to the items during the organization's normal weekday business hours with two day's advance notice. The organization will provide adequate security and insurance coverage for the items while they are stored in the donor's residence.[230]

Examples of unrelated use that did not qualify are as follows:

• Antique car to university the car was put in storage in a professor's garage and never used by the university, which does not offer a curriculum such as antique car restoring ("failed to establish the car has not in fact been put to an unrelated use by [the university] nor has any pertinent information been submitted showing that at the time of the contribution it was reasonable to anticipate that the car would not be put to an unrelated use by the donee or explaining why the car has not been used by the college to date");[231]

• Violin to a charitable remainder annuity trust (it could not be determined whether charitable remainder beneficiary was in fact a charity because the musical instrument had been sold);[232]

• Horse to American Cancer Society (did not provide any evidence that the horse was used in fund raising activities);[233]

[226] Priv. Ltr. Rul. 8145085 (Aug. 13, 1981).
[227] Priv. Ltr. Rul. 8204167 (Oct. 30, 1981).
[228] Priv. Ltr. Rul. 8143029 (July 29, 1981).
[229] Priv. Ltr. Rul. 8726010 (March 20, 1987).
[230] Priv. Ltr. Rul. 8535019 (May 30, 1985).
[231] Priv. Ltr. Rul. 80-09-027 (Nov. 29, 1979).
[232] Section 170(a)(3) does not apply; Priv. Ltr. Rul. 94-52-026 (Dec. 30, 1994).
[233] *Coleman v. Comm'r*, 56 T.C.M. (CCH) 710 (1988).

- Paintings to cancer center (most of the paintings were not used at all, were either stored or sold and the use was therefore unrelated to the purpose or function of the cancer society);[234] and

- Painting to private non-sectarian medical school to display in a bio-medical education and research center, presumably in a location where it may be viewed by students, faculty, patients, and visitors to the medical school.[235]

Based on these examples, it is difficult to argue that the donation of artwork that is not physically displayed would qualify as "related use." Not physically displaying or using the artwork is inconsistent with the available examples from Private Letter Rulings and Treasury Regulations. Storing the artwork and periodically giving lectures during which the artwork is physically displayed would be more consistent with the available examples than only publicly displaying images or reproductions of the artwork. The donee must generally display the artwork and advertise its availability so that there is actual foot traffic by the public to see, be educated by, and enjoy the use and access to the artwork. While it may be possible for the charity to use images of the artwork that come along with the rights to ownership, an IRS auditor may be skeptical as to whether artwork is actually used when it is instead stored safely and not displayed. There is also a potential copyright law issue if the donor does not own the copyright to use pictures of the art.

b. Artwork Copyright Issues

A donor who owns both a work of art and the copyright to the work must donate both the artwork and the copyright to the charity for the donation to qualify for the charitable income tax deduction.[236] If a donor who owns both elements donates only the physical work of art or the copyright without donating both, the donor is not permitted to receive a charitable deduction for the donation because it will be disallowed as a donation of only a partial interest.[237] However, if the donor owns only the artwork but not the copyright to the artwork, then the donor may receive a charitable deduction for a contribution of the work of art only.[238]

Unless the purchaser of a painting has a written document signed by the painter that explicitly states that the artist is transferring the copyright, then the purchaser only has the right to use the physical piece of art. [239] The purchaser can display the painting, destroy the painting, lend the painting, sell the painting, etc., but may not make copies of the painting, license the painting,

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[234] *Jennings v. Comm'r*, 56 T.C.M. (CCH) 595 (1988).

[235] General Counsel Memorandum 38804 (Oct. 15, 1981).

[236] Income tax statutes treat the work of art and the copyright as two distinct interest in the same property. *Portfolio 815-3rd: Planning for Authors, Musicians, Artist, and Collectors*, BLOOMBERG LAW. However, both gift and estate statutes explicitly allow for the treatment of a work of art and copyright on the work as separate properties for charitable tax deduction purposes if each is given for a related use. *See* §2522(c)(3), §2055(e)(4).

[237] For contributions where the tax payer is not transferring their entire interest in that property, the deduction of that contribution of partial interest in a property is denied.§170(f)(3)(A), §170(f)(3)(B)(ii); Reg. §1.170A-7(b)(1)(i).

[238] Reg. §1.7.70A-7(a)(2)(i) "A deduction is allowed without regard to this section for a contribution of a partial interest in property if such interest is the taxpayer's entire interest in the property, such as income interest or a remainder interest."

[239] An invoice and Certificate of authenticity do not transfer copyright, only ownership of the painting. If the artist is dead, the buyer of the art work needs consent from whatever entity has inherited the copyrights (heirs, estate, or other foundations and charities).

or otherwise exercise the rights of a copyright holder because the copyright remains with the painter.

If a donor does not hold the copyright to the paintings, then it would be necessary to physically display the paintings in a charitable or educational manner in order to qualify for an income tax deduction for the charitable contribution of the paintings because the donor does not have the rights to use reproductions of the paintings. The donee could not, for example, give lectures using such reproductions or distribute prints or advertisements that display a reproduction of the artwork. Therefore, in order for the paintings to be used in furtherance of the organization's tax-exempt purpose, they would need to be physically displayed.

23. Distributions from a Donor Advised Fund Can Satisfy a Donor's Charitable Pledge (For Now)

Section 4 of IRS Notice 2017-73 advised that the Treasury Department and the IRS are considering proposed regulations to provide that "a distribution from a DAF to a charity to which a Donor/Advisor has made a charitable pledge (whether or not enforceable under local law) will not be considered to result in a more than incidental benefit to the Donor/Advisor if the following requirements are satisfied:

> (1) the sponsoring organization makes no reference to the existence of a charitable pledge when making the DAF distribution;
>
> (2) no Donor/Advisor receives, directly or indirectly, any other benefit that is more than incidental (as discussed in this notice and as further defined in future proposed regulations) on account of the DAF distribution; and
>
> (3) a Donor/Advisor does not attempt to claim a charitable contribution deduction under 170(a) with respect to the DAF distribution, even if the distributee charity erroneously sends the Donor/Advisor a written acknowledgment in accordance with 170(f)(8) with respect to the DAF distribution."

Section 7 of the Notice provides that "Taxpayers may rely on the rules described in section 4 until additional guidance is issued."

It is noteworthy that a charitable pledge made to a Private Foundation may implicate the self-dealing rules, although the making of a pledge by a disqualified person to a Private Foundation without more is not considered to be an act of self-dealing.[240]

24. Charitable Contributions Required By Governmental Agencies, Contractual Penalty, or Other Non-Generosity-Motivated Purpose

[240] Treas. Reg. 53.4941(d)-2(c)(3) (as amended in 1995).

Some taxpayers are required or otherwise induced to make charitable donations as the result of inappropriate behavior or actions, breach of contract, or by court order or agreement with prosecutors or governmental officials.[241]

In general, IRC § 162(f) provides that a business expense deduction is not permitted "for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law."

A taxpayer may receive a business deduction if the expense is deemed to be an ordinary and necessary expense for the operation of a business under IRC § 162 or a payment to maintain or rehabilitate the business reputation of the taxpayer, but this can be a difficult standard to meet. The 1996 Tax Court opinion *Rothner v. Commissioner*[242] defined the terms "ordinary" and "necessary" as follows:

> [T]he term "ordinary" has been defined as "normal, usual, or customary." A payment of an expense is "normal" if it arises from an action that is ordinarily to be expected of one in the taxpayer's position. Although an expense may be incurred only once in a taxpayer's lifetime, it is ordinary if the transaction that gives rise to it is "of common or frequent occurrence in the type of business" in which the taxpayer is engaged.
>
> To be "necessary," an expense need only meet the minimal requirement that it be appropriate and helpful for the development of the taxpayer's business. An expense is not to be considered unnecessary simply because the taxpayer could have avoided it by pursuing a different course of conduct.[243]

The Tax Court held that a fine paid to the Chicago Mercantile Exchange in settlement of a disciplinary proceeding was deductible as an ordinary and necessary business expense. The payment of the fine was "ordinary" because the payment "settled the disciplinary proceedings and allowed petitioner to resume his business activities without further disruption" and was a "response that could ordinarily be expected from one in [the taxpayer's] situation." The court emphasized that "within the context and meaning of the statute allowing deductions for ordinary and necessary expenses, a private wrongdoing in the course of conducting a business is not extraordinary." Payment of the fine was "necessary" because the taxpayer "avoided any further expense and risk associated with continuation of the proceedings. . . . [and] was able to resume his business activities without further disruption."

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241 Richard L. Fox, *Deduction For $10 Million Fine Paid by NBA Owner Out of Bounds*, Charitable Planning Newsletter #320 (September 26, 2022) at http://www.leimbergservices.com. Copyright © 2022 Leimberg Information Services, Inc. (LISI).
242 72 T.C.M. (CCH) 801 (1996).
243 Citations omitted.

In the 1986 opinion *Gilliam v. Commissioner*,[244] the Tax Court held that expenses for legal fees and claim settlement related to the taxpayer's disorderly conduct on an airplane during business travel were not ordinary expenses directly in or in furtherance of the conduct of his trades or businesses. Instead, "the activities merely occurred in the course of transportation connected with [the taxpayer's] trades or businesses." The court acknowledged that while "[i]t undoubtedly is ordinary for people in [the taxpayer's] trades or businesses to travel (and to travel by air) in the course of such trades or businesses[,] . . . it is [not] ordinary for people in such trades or businesses to be involved in altercations of the sort here involved."

Although *Rothner* and *Gilliam* do not involve payments to a charitable organization, the principles regarding the types of payments that qualify as ordinary and necessary expenses for the operation of a business would apply when determining the deductibility of required payments to a charitable organization.

25. Avoiding Imposition of the Section 1374 Unrecognized Built-In Gain Rules

A C corporation that becomes an S corporation has items of "unrecognized built-in gain" that will be taxed at the S corporation level if and when sold or disposed of within 5 years of when the S election was made. IRC § 1374 provides that assets owned by a C corporation that are worth more than their tax basis at the time that an S election is made must be tracked and the revenues from the liquidation or sale of those assets within 5 years of conversion will be taxed at the S corporation level as if it were a C corporation each year for purposes of measuring the income and paying the 21% corporate level tax.

Examples of unrecognized built-in gain items owned by a cash basis professional corporation would include accounts receivable, furniture and equipment (including furniture and equipment that is fully depreciated and subject to depreciation recapture), and any goodwill owned by the entity.

These "hot assets" may be transferred by the S corporation before sale to a charitable remainder unitrust, which can sell the assets and pay no income tax at the time of sale.

The most common and expedient way to avoid the unrecognized built-in gain rules is to accrue a large expense on the books of the company that equals or exceeds the unrecognized built-in gain that is otherwise applicable on the last day of the C corporation year before the S election is made (normally December 31st, with the S election to be effective the following January 1st).

For example, if a cash basis professional practice S corporation has $100,000 of accounts receivable, $200,000 of goodwill, and the fair market value of its furniture and equipment exceeds the tax basis by $100,000, then an amount that is equal to or exceeds the total of these three amounts ($400,000) may be declared to be owed as compensation for services previously rendered to the company by one or more of the employees of the corporation. The compensation may also then be declared as accrued as a bonus payable to them as of the last day of the last C corporation year, assuming that this will qualify as reasonable compensation.[245] This bonus must actually be

244 51 T.C.M. (CCH) 515 (1986).
245 Rev. Rul. 74-44.

paid within 75 days of the effective date of the S election with respect to any individual who is a 5% or more shareholder in the company.[246] Taxpayers may also consider executing deferred compensation agreements and corroborating the reasons for the compensation being offered.

Further, this example assumes that the corporation is on the cash method of accounting, as opposed to the accrual method of accounting. The 2017 Tax Cuts and Jobs Act provides that corporations having less than $25,000,000 per year in gross receipts for the previous 3 years may use the cash method of accounting in lieu of the accrual method, which was increased from the previous threshold of $5,000,000.[247] Additionally, the Act provides that inventory-based businesses can now use the cash method if they have less than $25,000,000 in gross receipts.

Those who want to change their current method of accounting must file a Form 3115 to gain the Commissioner's consent.[248] Taxpayers should be wary, however, because requesting the Commissioner's consent via Form 3115 may only happen once every 5 years, per Rev. Proc. 2015-13.[249]

Another method of reducing unrecognized built-in gains would be to purchase assets that would yield a depreciation deduction for the corporation. In the example above, for instance, the practice corporation might purchase $80,000 worth of computer and copier equipment that can be immediately expensed via a Section 179 deduction or under the new bonus deprecation rules under Section 168, so that the bonus compensation would only need to be $320,000. The furniture and equipment would have to be actually purchased and "placed in service" on or before the last day of the C corporation tax year to qualify. Other assets and liabilities must also be considered but are beyond the scope of this simplified example.

Any accrued bonus should be paid within a reasonable time in addition to the normal compensation that shareholder employees would receive. For example, if a shareholder employee is normally paid $20,000 a month and a $60,000 bonus is declared, it would not be safe to stop paying the salary and to instead classify the $20,000 a month as a bonus, because the IRS may argue that the accrued bonus was not genuine. Many practices will therefore borrow money from a bank or shareholders, and actually pay the bonus, while then repaying the loan amounts over a period of months or years. The lender can receive a lien on the assets of the professional practice to stay in front of any potential future creditors of the practice. For this reason, many practices elect to keep the debt in place indefinitely, and to simply pay reasonable and tax-deductible interest on that loan.

While the bonus paid will be taxable to the employee shareholder, a deduction will be received on the S corporation tax return at the time of payment, so the bonus will "wash" for income tax purposes, but employment taxes will be payable thereon.

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[246] Treas. Reg. § 1.1374-4(c).
[247] IRC § 448(c)(1).
[248] Treas. Reg. § 1.446-1(e)(3)(i).
[249] Rev. Proc. 2015-13 § 05.04(1) ("if during any of the five taxable years ending with the year of change a taxpayer changed, or applied for consent to change, its overall method of accounting … the taxpayer may not request the Commissioner's consent … under the automatic change procedures."). For more on changes in accounting, *see* Treas. Reg. § 1.381(c)(4)-1.

26. Planning With S Corporations and Charitable Remainder Trusts

Closely-held business interests, such as S corporation ownership, make up a large amount of wealth in the United States, so it should come as no surprise that planners are frequently asked about charitable contributions of S corporation stock or assets of an S corporation and minimizing tax exposure.

Charitable Remainder Trusts cannot own S corporation stock or member interests in LLCs taxed as S corporations without causing loss of the S election. Under Treas. Reg. 1.337(d) – 4, if an S-corporation were to,

> [T]ransfer all or substantially all of its assets to one or more tax-exempt entities, or one that becomes a tax-exempt entity, that corporation must recognize gain or loss as if the assets were sold at fair market values.

Therefore, a tax-exempt entity, like a Charitable Remainder Trust or other charitable entity can trigger income tax as if the assets sold at fair market value.[250]

The IRS defines "substantially all" as over 80% of a corporation's assets, although some instances have suggested that "substantially all" can be anywhere between at least 65% and 80%. Conservative planners will often recommend an asset transfer of no more than 60% to 65% to ensure compliance. If a corporation transfers substantially all of its assets to a charity or CRT, it loses the benefits of transferring appreciated property to charity and loses the capital gains tax avoidance.

The sale of S Corporation stock by a charity also "shall be taken into account when computing the unrelated business taxable income" that will subject the charity to income tax in generally the same manner that would apply if the stock was sold by an individual.[251] Any loss or gain, not computed as part of its unrelated business taxable income, from the sale of S corporation stock by a charity results in ordinary income.[252]

Charitable Remainder Trusts are discussed in Chapter 2 and are commonly used as a vehicle to receive appreciated assets that can be sold by the trust so that the income tax on the income from sale is deferred over the period of time that the grantor or other annual payment recipient receives payments. Unfortunately, Charitable Remainder Trusts are not eligible to own S-Corporation stock, but a Charitable Remainder Trust can own an option to purchase S-Corporation stock.

Some advisors are comfortable having the owner of S corporation interests give a binding legal option to purchase the S corporation ownership to an individual who may then donate the option right to a Charitable Remainder Trust or other charitable organization. An option to purchase S corporation stock does not constitute stock of the company but should be carefully

[250] Treas. Reg. §1.337(d) -4.
[251] 26 U.S.C. §512(e)
[252] 26 U.S.C. §512(a)(F).

structured in thorough and arm's-length documents to ensure that it is not considered to be "disguised stock."[253]

The IRS-promulgated regulations under IRC § 337(d) prevent the circumvention of gain recognition through the use of tax-exempt organizations, such as a CRUT. However, the IRS has indicated that the "regulations do not affect the tax treatment of a corporation's gift of a portion of its assets to charity" but "apply only to transfers of all or substantially all of the assets of a taxable corporation to a tax-exempt entity or a taxable corporation's conversion to a tax-exempt entity."

To illustrate potential S corporation charitable planning, consider the following example:

Alice Inc. forms a CRT as a grantor/beneficiary. The CRT formed by Alice Inc. cannot hold shares of Alice Inc. but could instead hold Alice Inc.'s headquarters building, "Alice HQ." If the value of Alice HQ is "substantially all" of Alice Inc.'s assets, valued at $1,000,000, Alice Inc. must recognize gain as if it sold the building for $1,000,000 on the market—a taxable event. However, if the transfer is not "substantially all" of Alice Inc.'s assets, then there will be no event to recognize gain, thus a tax-free transfer.

Once Alice HQ is transferred into the CRT, the trust can sell the building for $1,000,000, and the Alice Inc. shareholders do not pay capital gains on the sale. With the $1,000,000 cash in the trust, the CRT (in this example, a CRUT) then pays Alice Inc. a percentage of the trust value each year. Alice Inc.'s shareholders receive a charitable deduction that is passed through to them via K-1 reporting, on an individual basis via the S corporation, based on an amount equal to the present value of the charitable remainder interest.

Alice Inc. makes use of a new building and does not lease or have use of the property and building now owned under the CRT so that the self-dealing rules do not apply.

There remains an open question of how the distribution from the CRUT back to the S corporation will be treated for income tax purposes. S corporations pass any allowable deduction through to their shareholders, who include the pass-through deduction with their own charitable deductions. One major reason to exercise caution with respect to the use of a CRT is the self-dealing rules and unrelated business taxable income (UBTI) (discussed in Chapter 4). The UBTI rules are designed to prevent tax-free treatment of investment income that is unrelated to the charitable purpose of the public charity or in this case, the CRUT. The consequences of UBTI treatment are severe for a CRT: the tax code now imposes a 100% excise tax on any UBTI within a CRT. Cautious planning can result in avoidance of UBTI treatment and the consequent excise tax. For example, IRC § 512(b) provides that there is no UBTI on dividends, interest, annuities, royalties, rents from real property, and rents from personal property "leased with such real property, if the rents attributable to such personal property are an incidental amount of the total

[253] An option to purchase S corporation stock is not stock, so you could put the option to purchase stock into a Charitable Remainder Trust. This has been referred to as the Option Grant Strategy. *4.14.4 Option Grant Strategy*, Crescendo Interactive, Inc., https://giftlawpro.giftlegacy.com/glawpro_subsection.jsp?WebID=GL1999-0001&CC=4&SS=14&SS2=4. However, after initially issuing a favorable PLR with respect to this strategy (PLR 9240017 (July 2, 1992)), the IRS later advised in PLR 9417005 (June 1, 1993) that the IRS "is now reconsidering the issues raised by this letter ruling. Accordingly, effective as of the date of this letter, we are withdrawing the letter ruling previously issued (PLR 9240017). No inference should be made from this withdrawal as to the proper tax treatment of the transfer to a charitable remainder trust of an option to purchase property."

rents received or accrued under the lease." Also, the charitable contribution deduction is determined at the shareholder level, and the treatment of these contributions may differ among shareholders given the limitations based on shareholder-adjusted gross income.

An entity taxed as an S corporation may convert to C corporation status, and then some or all of the shareholders/members may donate the C corporation stock to a Charitable Remainder Unitrust, subject to the other rules that apply thereto.

27. Using a Company-Affiliated Foundation to Assist Employees and Their Family Members Following a "Qualified Disaster"

A company-affiliated Private Foundation (a Private Foundation of which the company is a disqualified person) is generally not permitted to assist employees of the related company or family members of employees of the employer. There is an exception that applies if the employee or family member has been impacted by a "qualified disaster," which is defined under IRC § 139(c) as being any one of the following:

> (1) a disaster which results from a terroristic or military action (as defined in section 692(c)(2)),
>
> (2) a federally declared disaster (as defined by section 165(i)(5)(A)),
>
> (3) a disaster which results from an accident involving a common carrier, or from any other event, which is determined by the Secretary [of the Treasury] to be of a catastrophic nature, or
>
> (4) with respect to amounts [paid by a Federal, State, or local government, or agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare], a disaster which is determined by an applicable Federal, State, or local authority (as determined by the Secretary) to warrant assistance from the Federal, State, or local government or agency or instrumentality thereof.

The IRS has advised that payments made after a qualified disaster will be presumed to be consistent with the Private Foundation's charitable purpose, will not result in self-dealing by reason of the recipient being an employee or family member of an employee, and will not be taxable compensation to the recipient if all three of the following requirements are met:

1. The class of beneficiaries is large or indefinite (a "charitable class"),

2. The recipients are selected based on an objective determination of need, and,

3. The selection is made using either an independent selection committee or adequate substitute procedures to ensure that any

> benefit to the employer is incidental and tenuous. The foundation's selection committee is considered to be independent if a majority of the members of the committee consists of individuals who are not in a position to exercise substantial influence over the affairs of the employer.

In addition, any benefit to the company as a result of the payment must be incidental and tenuous when viewed in the totality of the circumstances.

It is also important to note that the self-dealing rules still apply to such payments. Therefore, if the recipient is a disqualified person with respect to the Private Foundation (such as an officer or over 2% donor of the foundation), then the payment would be an act of self-dealing and subject to the excise tax on self-dealing (covered in Chapter 4 of this book).

28. Planning with the IRC § 1411 Medicare Tax

Internal Revenue Code Section 1411 imposes a 3.8% Medicare Tax on married couples having taxable income exceeding $250,000 and individuals filing single or separately with income exceeding $150,000.

The threshold and Medicare tax are unaffected by donations that an individual or married couple will make to charity, but reducing the income of the married couple or separate filing individual can reduce the Medicare tax.

For example, John and Mary are married and have taxable income of $1 million a year.

They donate $100,000 each year to their favorite charity.

While they will now be taxed on $400,000 of income for federal income tax purposes, their Medicare tax will still be based upon $500,000 of income.

Alternatively, if they have an asset that pays them $100,000 of income and place that asset into an irrevocable trust that is taxed as a "complex trust" for income tax purposes, and if that irrevocable trust receives the $50,000 a year of income and transfers it to their 501(c)(3) family foundation or any other 501(c)(3) organization, they can receive an income tax deduction in the year that they transferred the investment asset or interest equal to the fair market value thereof, and then not pay income tax or Medicare tax on the $100,000 a year that is going directly to charity.

If the asset that pays $100,000 a year in income is worth $600,000, then they may have a $600,000 tax deduction, which could save them $222,000 in taxes at the 37% tax bracket. 3.8% of $100,000 is $3,800 of employment tax savings each year thereafter.

29. The Donation of Intellectual Property

Intellectual property (IP) donated to a Private Foundation will only be tax deductible to the extent of the lesser of the income tax basis that the donor has in the IP or the fair market value of the IP, except in situations where the charitable organization will receive royalties for licensing the use of the IP, as discussed below. The amount of the contribution for purposes of determining the deduction is reduced by "the amount of gain that would have been long-term capital gain if the taxpayer sold the property at fair market value on the date of the contribution."[254]

For purposes of this deduction, IP includes any of the following:

- patents,
- copyrights, other than a copyright:
    - held by "a taxpayer whose personal efforts created such property"[255] or
    - held by "a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer"[256] who created the property,
- trademarks,
- trade names,
- trade secrets,
- know-hows,
- software, other than software:
    - that "is readily available for purchase by the general public,
    - is subject to a nonexclusive license, and
    - has not been substantially modified"[257]),
- property similar to the above, and
- applications or registrations of such property.

The tax deduction to the donor will be based upon the qualified donee income received by the Public Charity in the 10 years following the transfer. "Qualified donee income" is defined as "any net income received by or accrued to the donee which is properly allocable to the qualified intellectual property."[258] The amount of the deduction resulting from qualified donee income is not limited to the fair market value of the IP.

[254] I.R.C. § 170(e)(1).
[255] I.R.C. § 1221(a)(3)(A).
[256] I.R.C. § 1221(a)(3)(C).
[257] I.R.C. § 197(e)(3)(A)(i).
[258] I.R.C. § 170(m)(3).

The deduction begins at 100% of qualified done income with respect to the contribution in the first and second taxable years of the donor ending on or after the contribution and then tapers down according to the following table:[259]

Taxable Year of Donor Ending on or After Date of Contribution:	Applicable Percentage:
1st	100
2nd	100
3rd	90
4th	80
5th	70
6th	60
7th	50
8th	40
9th	30
10th	20
11th	10
12th	10

I.R.C. §§ 170(m) and 6050L provide several requirements related to the Qualified Intellectual Property Deduction:

- The aggregate amount of the additional annual deduction is deductible only to the extent that it exceeds the amount of the initial deduction for the contribution of the IP.[260]
- The additional amount deducted "must be received by or accrued to the donee for the taxable year of the donee which ends within or with such taxable year of the donor."[261]
- Income "received by or accrued to the donee after the 10-year period beginning on the date of the contribution of" the IP is not deductible by the donor.[262] This is the case even though the statute provides applicable percentages through year 12. Furthermore, the deduction is not permissible "for any taxable year of the donor after the 12th taxable year of the donor which ends on or after the date of [the IP] contribution."[263]

[259] I.R.C. § 170(m)(7).
[260] I.R.C. § 170(m)(2).
[261] I.R.C. § 170(m)(4).
[262] I.R.C. § 170(m)(5).
[263] I.R.C. § 170(m)(10)(C).

- Income "received by or accrued to the donee after the expiration of the legal life of" the IP is not deductible by the donor.[264]

- The done must "inform the donee at the time of such contribution that the donor intends to treat such contribution as a qualified intellectual property contribution."[265]

- "[F]or any taxable year of the donee that includes any portion of the 10-year period beginning on the date of the contribution, but not for taxable years beginning after the expiration of the legal life of the qualified intellectual property,"[266] the donee must annually report the income from the IP to the IRS using Form 8899, *Notice of Income From Donated Intellectual Property*.[267] The donee must also provide a copy of the form to the donor.[268] The form must include the following information:

    - The name, address, taxable year, and employer identification number of the donee making the information return;

    - The name, address, and taxpayer identification number of the donor;

    - A description of the qualified intellectual property in sufficient detail to identify the qualified intellectual property received by such donee;

    - The date of the contribution to the donee;

    - The amount of net income of the donee for the taxable year that is properly allocable to the qualified intellectual property . . . ; and

    - Such other information as may be specified by the form or its instructions.[269]

An example of how this works is as follows:

On January 1, 2020, John Q. Investor ("donor") donates a patent to a 501(c)(3) University. At the time that it makes the contribution, the donor informs the University that it intends to treat the contribution as a qualified intellectual property contribution. The fair market value of the patent is $200,000 at the time of the contribution. The donor's basis in the patent is $0 because it wrote off the development research. The patent has 18 years of its legal life remaining.

The donor cannot take a deduction when it donates the patent to the University because the deduction amount will be $0, the lesser of its basis in the property ($0) and the property's FMV ($1 million).

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[264] I.R.C. § 170(m)(6).
[265] I.R.C. § 170(m)(8)(B).
[266] I.R.C. § 1.6050L-2(a).
[267] I.R.C. § 6050L(b).
[268] Treas. Reg. § 1.6050L-2(c) (as amended in 2008).
[269] Treas. Reg. § 1.6050L-2(b) (as amended in 2008).

However, this patent generates income to the University of $10,000 a year for the next 15 years. For the first 10 years following the donation of the property, the University files a Form 8899 with the IRS that includes all of the necessary reporting information, including the amount of net income for the taxable year that is properly allocable to the qualified intellectual property. The University also provides a copy of the Form to the donor.

The donor can receive deductions in the following amounts over that 15-year period:

Year Following the Date of Contribution:	Taxable Year of Donor Ending On or After Date of Contribution:	Remaining Legal Life of Patent:	Applicable Percentage:	Annual Qualified Donee Income Reported on Form 8899:	Donor's Deduction:
1 (1/1/2020 – 12/31/2020)	1st	18 years	100	$10,000	$10,000
2 (1/1/2021 – 12/31/2021)	2nd	17 years	100	$10,000	$10,000
3 (1/1/2022 – 12/31/2022)	3rd	16 years	90	$10,000	$9,000
4 (1/1/2023 – 12/31/2023)	4th	15 years	80	$10,000	$8,000
5 (1/1/2024 – 12/31/2024)	5th	14 years	70	$10,000	$7,000
6 (1/1/2025 – 12/31/2025)	6th	13 years	60	$10,000	$6,000
7 (1/1/2026 – 12/31/2026)	7th	12 years	50	$10,000	$5,000
8 (1/1/2027 – 12/31/2027)	8th	11 years	40	$10,000	$4,000
9 (1/1/2028 – 12/31/2028)	9th	10 years	30	$10,000	$3,000
10 (1/1/2029 – 12/31/2029)	10th	9 years	20	$10,000	$2,000
11 (1/1/2030 – 12/31/2030)	11th	8 years	10	$10,000	$0
12 (1/1/2031 – 12/31/2031)	12th	7 years	10	$10,000	$0

Year Following the Date of Contribution:	Taxable Year of Donor Ending On or After Date of Contribution:	Remaining Legal Life of Patent:	Applicable Percentage:	Annual Qualified Donee Income Reported on Form 8899:	Donor’s Deduction:
13 (1/1/2032 – 12/31/2032)	13th	6 years	0	$10,000	$0
14 (1/1/2023 – 12/31/2023)	14th	5 years	0	$10,000	$0
15 (1/1/2024 – 12/31/2024)	15th	4 years	0	$10,000	$0

Because the donor’s initial deduction at the time of the contribution was $0, the entire deduction amount can be taken each year. IRC § 170(m)(2) provides that the deduction allowed is increased only to the extent that the aggregate amount of such increases with respect to such contribution exceed the amount allowed as a deduction under subsection § 170(a) with respect to such contribution. In other words, if a deduction had been taken at the time of the contribution, the aggregate amount of the annual deductions for qualified donee income will be reduced by the amount of the initial deduction.

Finally, a donor should be very careful when placing restrictions on a gift of IP. In Revenue Ruling 2003-28,[270] the IRS held the following in relation to gifts of IP subject to donor restrictions:

> (1) A taxpayer's contribution to a qualified charity of a license to use a patent is not deductible under section 170(a) if the taxpayer retains any substantial right in the patent.
>
> (2) A taxpayer's contribution to a qualified charity of a patent subject to a conditional reversion is not deductible under section 170(a), unless the likelihood of the reversion is so remote as to be negligible.
>
> (3) A taxpayer's contribution to a qualified charity of a patent subject to a license or transfer restriction is deductible under section 170(a), assuming all other applicable requirements of section 170 are satisfied, and subject to the percentage limitations of section 170, but the restriction reduces what would otherwise be the fair market value of the patent at the time of the contribution, and therefore reduces the amount of the charitable contribution for section 170 purposes.

[270] 2003-11 I.R.B. 594.

Note as well that I.R.C. § 512(b) excludes patent royalty payments from unrelated business taxable income (UBTI) (see Chapter 4 for further discussion of UBTI).

30. Automobile Expenses – 14 cents per mile permitted

While the time and value of charitable services does not entitle the donor to an income tax deduction, mileage put on a donor's vehicle for the purpose of benefitting a charitable organization can be deducted. The deduction will be based upon the IRS published "standard mileage rates". The standard mileage rates for 2023 are 65.5 cents per mile driven for business use, 22 cents per mile driven for medical or moving expense purposes, and only 14 cents per mile for charitable purposes.[271]

Alternatively, a volunteer can be reimbursed for expenses, which are not considered to be gross income if proper rules are followed.

Beginning on January 1, 2024, the standard mileage rates for the use of a car (also vans, pickups or panel trucks) is 14 cents per mile driven in service of charitable organizations. The rate is set by statute and remains unchanged from 2023.[272]

31. Charitable Auctions

Many well-run charities have auctions that either stand alone or are conducted in conjunction with galas or other events.

Tax laws that apply to the various components of a charitable auction should be understood by the charitable entity, purchasers, and their respective advisors.

A charity auction may be considered to be a "business" for purposes of the tax upon business for purposes of the tax on Unrelated Business Taxable Income, but an exception from that tax will almost always apply.

The most common exception is that the auction is not considered to be a "regularly carried on" activity.

Activities that are carried on only once a year are normally not considered to be "regularly carried on," but an activity that occurs every week or calendar quarter may be.

The Regulations provide that annual and infrequently occurring functions are not "regularly carried on":

> Certain intermittent income producing activities occur so infrequently that neither their recurrence nor the manner of their conduct will cause them to be regarded as trade or business regularly carried on. For example, income producing or fund raising activities lasting only a short period of time will not ordinarily be treated as

[271] IR-2022-234 December 29, 2022

[272] https://www.irs.gov/newsroom/irs-issues-standard-mileage-rates-for-2024-mileage-rate-increases-to-67-cents-a-mile-up-1-point-5-cents-from-2023.

> regularly carried on if they recur only occasionally or sporadically. Furthermore, such activities will not be regarded as regularly carried on merely because they are conducted on an annually recurrent basis. Accordingly, income derived from the conduct of an annual dance or similar fund raising event for charity would not be income from trade or business regularly carried on.[273]

Another exception applies where substantially all of the items sold have been donated to the exempt organization. Many organizations, however, purchase items to be sold at auction, including travel packages, so this exception may not always apply.

A third exception is for a business that has substantially all of the work associated therewith performed by volunteers. Many well-organized charities have employees who are not volunteers, so this exception will not always apply. The definition of "substantially all" in this context has not been clearly defined. Courts and the IRS have in various instances determined that "substantially all" was met by 94%,[274] 97%,[275] and 87%[276] of the work being performed by non-compensated volunteers. However, these are not clear thresholds by which the "substantially all" requirement can be determined in any particular case.

32. <u>Donation of Items To Be Auctioned</u>

The next common question is whether the donors who donate items to be auctioned can receive an income tax deduction for the gift of the item to the charity or as a business advertising expense.

When the item is appreciated tangible personal property, the deduction will be based upon the donor's income tax basis in the property. The use of property to be sold in an auction is not considered to be "related purpose" in the same way that items generally used in a charity will be.

There is also no charitable deduction allowed for a "use gift," such as when an individual owning a condominium or timeshare allows it to be used by the high bidder at a charitable auction.

There is also no charitable donation permitted for a gift of services, such as if a lawyer agrees to draft an estate plan for the highest bidder.

The next question is whether the high bidder for an item may receive an income tax deduction where a check is written to the charity in an amount that exceeds the fair market value of what the donor has purchased.

Although the fact that a person was the highest bidder at an auction could be viewed as evidence that the fair market value of the item was determined by the auction process, quite often items will be sold at a charity auction for more than their fair market value. If the bidder bids higher than fair market value due to detached and disinterested generosity,[277] the bidder can be

[273] Treas. Reg. § 1.513-1(c)(2)(iii).
[274] *St. Joseph Farms v. Commissioner*, 85 T.C. 9 (1985), *nonacq*., 1986-2 C.B. 1.
[275] TAM 8040014.
[276] PLR 7806039.
[277] *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960).

entitled to a charitable deduction in the amount by which the winning bid exceeds the fair market value of the item.

33. Gifting Promissory Notes

Sometimes individuals or entities will sell a business or appreciated assets in exchange for the receipt of a promissory note, and will pay income tax on the sale only as principal payments are received on such note under the installment method of taxation.[278] Some donors may wish to transfer such notes and all rights associated therewith to a charity in order to receive a charitable donation.

The Tax Court held in its 1964 opinion, *The Humacid Co. v. Commissioner*,[279] that a donor did not recognize income on the donation of an installment sale promissory note, and did not recognize income upon the payment of the note, by the obligee, three weeks after the donation. The promissory notes would have yielded income to the taxpayer if the notes had been collected before the donation. A taxpayer can therefore both avoid capital gains on a donated asset as well as deduct the value of the asset (although under certain circumstances the deduction is limited to the donor's basis).

The opinion included the following summary of the law with respect to such gifts of appreciated property:

> The law with respect to gifts of appreciated property is well established. A gift of appreciated property does not result in income to the donor so long as he gives the property away absolutely and parts with title thereto before the property gives rise to income by way of a sale.[280]

The authors have found no contrary authority to this decision, although the IRS did not acquiesce to the opinion.

34. New Tax Law Rewards Charitable IRA Retirees with a $50,000 Income Tax Deferral Opportunity281

The SECURE 2.0 Act of 2022, enabled individuals over age 70 1/2 to transfer up to $50,000 to a charitable remainder trust or into a charitable annuity arrangement once in their lifetime.

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[278] I.R.C. § 453.
[279] 42 T.C. 894 (1964).
[280] *Id.* at 913 (citing *Stuart A. Rogers*, 38 T.C. 785 , 788-789 (1962); *Elizabeth H. Potter*, 38 T.C. 951 (1962); *Campbell v. Prothro*, 209 F. 2d 331 (CA. O, 1954); *Estate of W. G. Farrier*, 15 T.C. 277 (1950); *Elsie SoRelle*, 22 T.C. 459 , 476-479 (1954); *South Lake Farms, Inc.*, 36 T.C. 1027 (1961)).
[281] Alan Gassman, *New Tax Law Rewards Charitable IRA Retirees With A $50,000 Income Tax Deferral Opportunity*, Forbes (Dec. 30, 2022, 5:38 PM), https://www.forbes.com/sites/alangassman/2022/12/30/new-tax-law-rewards-charitable-ira-retirees-with-a-50000-income-tax-deferral-opportunity.

Since 2006, individuals who are required to take annual minimum distributions from their IRA accounts have had the option of transferring up to $100,000 per year directly from one or more IRAs to one or more public charities and/or private operating foundations. This transfer to a public charity is known as a "qualified charitable distribution" (QCD). The Internal Revenue Code (IRC) defines qualified charitable distribution as "any distribution from an individual retirement plan . . . which is made directly by the trustee to [a public charity or private operating foundation] and which is made on or after the date that the individual for whose benefit the plan is maintained has reached age 70 1/2."[282] Note that this is a younger age than when IRA owners are required to begin taking required minimum distributions at age 72 (73 in 2023).

These qualified charitable distribution rules under IRC § 408(d)(8) have resulted in a great many donations to charities that would not have otherwise occurred. The most effective transfer to charity from a tax-planning standpoint for most taxpayers is to take ordinary income subject to federal income tax and to allow that ordinary income amount to go to charity.

SECURE 2.0 indexes the $100,000 annual exclusion limit for inflation beginning in 2024 and provides a new option to take advantage of the exclusion that began in 2023 for those taxpayers who have reached age 70 1/2 and are required to take minimum distributions. The 2024 QCD limit is $105,000.

SECURE 2.0 permits a taxpayer to make a one-time $50,000 distribution directly from an IRA or IRAs to a charitable remainder trust or a charitable annuity and make a one-time election to treat the contributions as if they were qualified charitable distributions made directly to a charitable entity.

Unlike a direct charitable contribution, contributions to a split-interest entity benefit not only the charity but also the individual IRA owner. The overall economic impact is that at least a small portion of what is transferred goes to charity and up to 90% of the economic value of what is transferred (up to approximately $45,000) can be paid out to the individual IRA owner over a selected term of years, not exceeding 20 years, or for his or her lifetime.

However, it is unclear under SECURE 2.0 whether IRA distributions to a charitable remainder trust that pays the IRA owner and/or spouse over a selected term of years will qualify for the QCD election. The new law excludes distributions to split-interests trusts if any person holds an income interest in the Charitable Remainder Trusts other than the individual for whose benefit such account is maintained and/or his or her spouse. Under a term-of-years charitable remainder trust, if the non-charitable beneficiary and spouse died before the term ends, their children or another person(s) can receive the remaining payments. Those children or other contingent beneficiaries would have contingent remainder income interests in the trust, and the law appears to exclude such a trust from receiving qualified charitable distributions.

Distributions to three types of split-interest entities qualify for the one-time QCD election: charitable remainder annuity trusts (CRATs), charitable remainder unitrusts (CRUTs), and charitable gift annuities. In addition to the general rules applicable to these entities, SECURE 2.0

[282] I.R.C. § 408(d)(8)(B).

places additional rules and requirements in order for distributions to qualify for the election for QCD treatment. The following chart lists these additional requirements:

Split-Interest Entity	IRC Section	Additional Rules and Requirements
Charitable Remainder Annuity Trust (CRAT)	664(d)(1)	• The CRAT must be funded exclusively by qualified charitable distributions from IRAs. • Generally, the deduction for a donation to a CRAT is based upon a percentage of the amount contributed. SECURE 2.0 provides that the entire qualified charitable distribution to a CRAT is not subject to income tax upon the transfer if a portion of the transfer to the CRAT would have been deductible if it had been a contribution of non-IRA personal funds or assets. Although no charitable deduction is received for the IRA owner, the ability to move moneys that would have been taxable into a CRAT that pays the money to stretch taxation out over time can be very advantageous. • No person holds an income interest in the CRAT other than the individual for whose benefit such account is maintained, the spouse of such individual, or both. • The income interest in the CRAT is nonassignable. • Distributions will be treated as ordinary income in the hands of the beneficiary to whom the payment is paid.
Charitable Remainder Unitrust (CRUT)	664(d)(2)	• The CRUT must be funded exclusively by qualified charitable distributions from IRAs. • Generally, the deduction for a donation to a CRUT is a percentage of the amount contributed. SECURE 2.0 provides that the entire qualified charitable distribution to a CRUT is not subject to income tax upon the transfer if the portion of the transfer going to charity would have been deductible if it had been a cash contribution from personal funds and not a distribution from an IRA. Although a charitable deduction is not given for a qualified charitable distribution, contributions must be "otherwise deductible," meaning that "a deduction for the entire value of the remainder interest in the distribution for the benefit of a specified charitable organization would be [but is not] allowable under [I.R.C. §] 170." • No person holds an income interest in the CRUT other than the individual for whose benefit such

		account is maintained, the spouse of such individual, or both. • The income interest in the CRUT is nonassignable. • Distributions will be treated as ordinary income in the hands of the beneficiary to whom the annuity is paid.
Charitable Gift Annuity	501(m)(5)	• The charitable gift annuity must be funded exclusively by qualified charitable distributions from IRAs. • The charitable gift annuity must commence fixed payments of 5% or more than the contribution amount not later than 1 year from the date of funding. • Generally, the deduction for a donation to a charitable gift annuity is a percentage of the amount contributed. SECURE 2.0 provides that the entire qualified charitable distribution made to a charity in exchange for a charitable gift annuity is not subject to income tax upon the transfer if the arrangement qualifies under the normal gift annuity rules (i.e., if the actuarially calculated portion of the transfer going to charity would have been deductible under the normal charitable annuity rules). Although a charitable deduction is not given for a qualified charitable distribution, the ability to not pay income tax on an IRA withdrawal and to pay the tax as annuity payments are received is significant. • No person holds an income interest in the charitable gift annuity other than the individual for whose benefit such account is maintained, the spouse of such individual, or both. • The income interest in the charitable gift annuity is nonassignable. • Qualified Charitable Distributions will not be treated as an investment in the contract for purposes of IRC § 72(c).

In a typical transaction, a donor with one of more IRAs can transfer $50,000 to a charity and receive an immediate life annuity that may pay a 73-year-old donor $2,850 per year for his or her lifetime and may pay a 76-year-old donor $3,050 per year for his or her lifetime.[283]

SECURE 2.0 permits a donor over age 70 1/2 or a charity to establish a charitable remainder unitrust that will receive up to $50,000 from the donor's IRA or IRAs and will then pay

[283] *Charitable Gift Annuity Calculator*, PlannedGiving.Com, https://charitablesolutions.plannedgiving.org/charitablesolutions/articles/74.html.

annual distributions to the donor and/or the donor's spouse for a term of years or the non-charitable beneficiary's lifetime. Unlike the annuity arrangement, the charitable remainder trust may delay payments or limit payments based upon the NIMCRUT and Flip NIMCRUT rules described below.

Under the new SECURE 2.0 rules, 100% of all payments received by the IRA owner or owner's spouse must be considered ordinary income.

For this reason, it is expected that existing charitable remainder trusts will not be used to receive IRA payments, because most existing charitable remainder trusts make payments that do not constitute 100% ordinary income. In addition, SECURE 2.0 requires that CRUTs and CRATs be funded exclusively by qualified charitable distributions.

a. Example

An example of how a CRUT, NIMCRUT, and a Flip NIMCRUT can work is as follows:

John is 75 years old and wishes to transfer $50,000 directly from his IRA to a charitable remainder trust.

In exchange for his contribution to the charitable remainder trust, he wants to receive annual payments for his lifetime and the lifetime of his wife, Amy, who is 70 years old.

John makes the transfer in January 2023 when the IRC § 7520 rate is 4.6%.

Based upon the IRS tables, he and Amy will receive an annual payment based upon 22.19% of the value of the trust assets, as measured every year until the death of the survivor of them, and for no less than 10 years in the unlikely event that both die within 10 years.

If they wanted to receive the maximum percentage amount for life without a 10-year minimum payment then this would be 15.52%.

If this were just for Tom's life, it would be 34.67% per year.

If it were for only 20 years (assuming you can do this on a term-of-years basis, as discussed above), it would be 10.875% per year.

Based upon an assumed rate of return of 4.6%, a charity selected by Tom and named in the trust agreement has a remainder interest initially considered to be worth $5,000 to satisfy the 10%-upon-inception remainder interest calculation.

The investments in the trust grow at 7% per year, so that in 10 years the trust has $60,413 (pre-tax) of assets under the first scenario, $53,254 (pre-tax) in assets under the second scenario, $63,402 (pre-tax) in assets under the third scenario, and $44,940 (pre-tax) in assets under the fourth scenario.

The distributions that Tom (and Amy) would receive each year and the amounts remaining to pass to the charity (assuming that Tom dies in 20 years and Amy dies in 25 years) under each scenario are as follows:

	Scenario 1		***Scenario 2***		***Scenario 3***		***Scenario 4***	
Year	**Value in Trust**	**Total Pre-Tax Payments**	**Value in Trust**	**Total Pre-Tax Payments**	**Value in Trust**	**Total Pre-Tax Payments**	**Value in Trust**	**Total Pre-Tax Payments**
5	**$27,678**	**$37,721**	**$37,468**	**$29,204**	**$14,643**	**$48,687**	**$45,677**	**$21,954**
10	**$12,144**	**$60,413**	**$24,004**	**$53,729**	**$2,899**	**$63,402**	**$37,487**	**$44,940**
15	**-**	**-**	**$15,379**	**$69,442**	**$574**	**$66,315**	**430,765**	**$63,804**
20	**-**	**-**	**$9,853**	**$79,508**	**$114**	**$66,889**	**$25,249**	**$79,285**

b. Potential Issues with Taking Advantage of the Election for QCD to a Split-Interest Entity

The major issue from an economic standpoint with taking advantage of this new QCD election is the legal fees incurred when setting up a split-interest entity. It can easily cost $2,000 to set up a decent charitable remainder trust and the charity will typically only receive about 10% of the initial contribution if the charitable remainder trust is designed to maximize payments to the grantor. Increasingly, however, charities will set up the split-interest entity free-of-cost to the donor. If the grantor is healthier than average, the charity will probably receive less than 10%. This is why many well-advised charities, other than the American Cancer Society, may consider giving packages of cigarettes and bottles of grain alcohol to their lifetime-payment charitable remainder trust donors each year in recognition of their contributions. This is also why well-advised unhealthy donors are unlikely to set up lifetime payment charitable remainder trusts or to accept packages of cigarettes or bottles of grain alcohol.

A charitable trust also has to file an annual return with the IRS, Form 5227, *Split-Interest Trust Information Return*, which can be expensive and time consuming.

As previously mentioned, the requirements that the trust must be funded exclusively by qualified charitable distributions and that 100% of all payments received by the IRA owner or owner's spouse have to be considered ordinary income make it disadvantageous to use an existing split-interest entity.

Online legal services companies like LegalZoom may be able to more inexpensively set up these entities or provide templates for doing so, but there is a risk that they will be drafted incorrectly, potentially disqualifying the donor from taking the election to treat the distribution as a QCD.

It is also essential to ensure that the trust be managed properly, with payments being made on schedule. Failure to adhere to the required formalities could cause disqualification of the charitable remainder trust back to the date of formation. This result occurred in the 2002 Eleventh Circuit case of *Estate of Atkinson v. Commissioner*,[284] where the taxpayer did not make payments and the Tax Court held that a charitable remainder trust would not qualify under the tax code to provide a tax deduction for the value of the remainder interest or deferral of income tax on trust sales and income, global search and replace, notwithstanding that it was properly drafted, signed, and funded. This resulted in the taxpayer losing her charitable deduction and requiring her to pay taxes on the charitable remainder trust income, as if she kept the charitable remainder trust assets that were sold and received the income that was received by the charitable remainder trust.

If not for these ongoing management requirements and setting aside consideration of legal fees, taking advantage of what is essentially a new $50,000 income tax deferral opportunity would otherwise be a no-brainer from a business standpoint for many taxpayers. Even if a wealthy taxpayer is not charitably inclined, SECURE 2.0 permits the donor to defer paying income tax on $50,000 of income by spreading that amount out over his or her lifetime or a term of years.

c. Sample Client Letter

The following letter can be freely reproduced and used to send to a client regarding this opportunity:

> Dear Client:
>
> This letter is to let you know of a new planning opportunity that applies with respect to your IRA and the Minimum Distribution Requirements.
>
> As I am sure you are aware, an individual who is over age 72 has an obligation to take a "minimum distribution" from his or her IRA or any pension plans.
>
> The minimum distribution is based upon a set percentage of the assets held under the IRA.
>
> As you are probably aware, the Tax Code allows up to $100,000 of IRA distributions to pass directly from an IRA to one or more charities.
>
> Such a payment can satisfy the Minimum Distribution Rules as to the amount transferred and facilitate avoidance of federal income tax on the amounts that go directly from the IRA to the charity.
>
> A technical term for this is a "Qualified Charitable Distribution" (QCD).
>
> In the new tax law provisions that are in the SECURE 2.0 Act that President Biden signed on December 29, 2022, there is a new opportunity with respect to the above.

[284] 309 F.3d 1290 (11th Cir. 2002).

That opportunity is the ability to direct up to $50,000 of IRA monies to a Charitable Annuity or Charitable Remainder Trust arrangement in order to avoid paying income tax on up to $50,000 of IRA distributions, while having the ability to receive distributions over time from a Charitable Annuity or Charitable Remainder Trust arrangement.

Under most Charitable Annuities, the charity would receive the IRA monies and use approximately half of those monies to fund an annual payment to the donor or the donor and the donor's spouse, while using the other half of the monies received to fund the charity itself.

For example, if a 75-year-old in good health gives $50,000 to a life insurance company in exchange for a life annuity, then the life insurance company may agree to pay the individual $5,000 a year for the rest of his or her life.

If the same individual gave $50,000 to his or her Synagogue or a public charity, the Synagogue or public charity would typically agree to pay the donor $3,300 a year for life, so that the donor would receive an income tax deduction for $24,179, and a stream of payments worth approximately $25,000 at the time of inception.

Charities are able to negotiate a more favorable arrangement with a donor, but the 50% setting is most common.

A Charitable Remainder Trust can pay a much greater benefit to the donor. With a Charitable Remainder Trust, the donor can be the Trustee and have the right to receive a set annual dollar amount (if the Trust is what is known as a "Charitable Remainder Annuity Trust") or a percentage of the Trust assets, as calculated each year (if the Trust is what is known as a "Charitable Remainder Unitrust").

The tax law requires that a Charitable Remainder Annuity Trust or Charitable Remainder Unitrust must be set up with amounts that enable the present value at the time of setup for the Charitable Remainder Interest to be at least 10% of the total value donated.

This is much more advantageous than a typical Charitable Annuity Contract, which is most often based upon a 50/50 proportion.

Examples of how this works are as follows:

> John is age 75, and wants to move $50,000 from his IRA to a Charitable Remainder Trust in order to save income taxes based upon 37% of $50,000, which is $18,500.
>
> John has $50,000 transferred from his IRA to a Charitable Remainder Unitrust that will pay him 10% of the value of the trust assets each year for his lifetime.
>
> If the Trust assets grow at 6% per year, then after 15 years there will be approximately $30,000 in the Trust to pass to charity, after John's death.

> Jill is 72 and wants to distribute $50,000 from her IRA to a charity in exchange for a charitable gift annuity. At a 6.2% payment rate, Jill will receive $3,100 per year for her lifetime if the annuity is only for her lifetime. Based on her life expectancy, she will receive payments totaling $45,000 and the charity will receive $25,000.
>
> If the annuity is for both her and her 71-year-old spouse's lifetimes, at a 5.5% payout rate they will receive $2,750 per year. Based on their life expectancies, they will receive payments totaling $52,000 and the charity will receive $25,000.

35. <u>Sharing Leased Space or Acreage With a 501(c)(3) Organization</u>

Oftentimes an individual or business will have an office, warehouse, manufacturing facility, or acreage and a desire to form or enhance the activities of a 501(c)(3) organization by allowing it to make use of such facilities or acreage.

If the 501(c)(3) organization is a Private Foundation or a Private Operating Foundation then the rules prevent the following:

- Charging the 501(c)(3) organization for rent or any services
- Receiving any direct or indirect benefit from the 501(c)(3) organization, other than incidental benefits that may be made available to the general public
- The 501(c)(3) organization cannot even reimburse the donor or any person or entity related to the donor for expenses incurred by the donor for the benefit of the 501(c)(3) Private Foundation or Private Operating Foundation.

For example, assume that Raj and Mary live on 50 acres and engage in farming, both commercially and in order to help teach members of the community how to design and implement efficient organic farming.

They decide to form a 501(c)(3) organization for the purpose of educating the public on farming methods and growing foods that can be donated to food banks. It is noteworthy that an organization that simply grows food and donates it to food banks and other worthy causes is not engaged in an activity that qualifies it for 501(c)(3) status unless additional charitable activities that may be educational or for the purpose of preserving nature are also involved.

Raj and Mary donate 5 acres of unencumbered property to the 501(c)(3) organization and take an income tax deduction for the value of the acreage.

A planning and zoning lawyer should be involved to help ensure that the 5 acres has road access (also known as "ingress and egress") and can stand on its own as a separate parcel. A real estate appraiser should also be consulted in advance of the donation, and there may need to be easements between the separated properties to satisfy zoning rules, land use compliance, and expected values.

Raj and Mary also allow the 501(c)(3) organization to use another 10 acres exclusively, based upon a written lease agreement. One question is how such a lease arrangement will impact state and local property tax exemptions or incentives that may apply for property that is homestead and/or greenbelted for agricultural uses.

They cannot charge rent for the use of the 10 acres, but they can donate money or other assets to the 501(c)(3) organization and receive an income tax deduction. The 501(c)(3) organization can use the monies to pay for expenses that would have otherwise been expenses of Raj and Mary if they had retained use and/or ownership of the acreage.

These expenses can include a proper share of the property taxes; separately metered electricity; separately metered water; insurance as attributable to the operation of the 501(c)(3) organization; and expenses incurred with caretakers and contractors who render services for the 501(c)(3) organization, commercial farm, and personal home.

It is important that the 501(c)(3) organization pay its share of expenses directly to the third parties and not as a reimbursement to Raj and Mary.

At some point in time the 501(c)(3) organization may qualify as a Public Charity if it has a significant physical school that operates on the property, which might teach farming techniques as its curriculum, or it receives significant support from donors, based upon the rules described in I.R.C. § 509(a).

It is acceptable for the 501(c)(3) organization to share common expenses with Raj and Mary. For example, if the electricity and water cannot be separately metered it would be acceptable for the 501(c)(3) organization to write a check to the electric and water companies for its fair share and Raj and Mary can write a check for their fair share.

Raj and Mary's children and grandchildren may be employed by the 501(c)(3) organization to provide "white collar services" but not as manual laborers as per the rules described in the section on self-dealing in Chapter 4.

No charitable deduction will be available for the fair market value of the use of the acreage that is leased to the 501(c)(3) organization.

The sale of the crops grown by the 501(c)(3) organization may be subject to the tax imposed upon unrelated business taxable income, but the donation or transfer of such crops to another legitimate 501(c)(3) organization for research or consumption by individuals in need should not be considered to be a constructive sale that would trigger the tax on unrelated business taxable income.

The above discussion does not cover everything that Raj and Mary need to know about this arrangement, but is a good platform for initial discussion and planning.

36. <u>Important Developments from the IRS</u>

1. Disregarded LLCs[285]

In 2012, the IRS issued Notice 2012-52, which provides that the IRS will treat the contribution of a disregarded single-member LLC as a tax-deductible contribution of the assets of the LLC for federal income tax purposes. In PLR 200150027 (August 7, 2001), a community trust desired to accept a donation of real property but wanted to insulate itself from environmental and other liability issues. The community trust proposed to organize a single-member LLC that would receive the donation. The community trust would be the sole member of the LLC and would appoint an unrelated individual to serve as manager. The IRS ruled that the LLC would be disregarded and would not have to file an Application for Exemption from Tax. Instead, it would be encompassed within the community trust's income tax return.

2. IRS No Longer Issues Favorable PLRs on Notes Contributed to LLCs That Are Partly Owned by CLATs or Other Charitable Vehicles

In Revenue Procedure 2021-40, published in September 2021, the IRS announced that it will no longer issue letter rulings on whether self-dealing occurs when a Private Foundation (or other entity subject to IRC § 4941) owns or receives an interest in a limited liability company that holds a promissory note owed by a Disqualified Person. This has been a popular method of estate tax avoidance whereby a donor sells assets to a dynasty trust and then contributes the note to an LLC. The donor then donates the 99% non-voting interest in the LLC to a zeroed-out CLAT that makes annual payments to one or more charities, with remaining assets after a term of years to pass to individuals without being subject to federal estate tax.

IRC § 4941(d)(1)(B) provides that the "lending of money or other extension of credit between a Private Foundation and a Disqualified Person" is a prohibited act of self-dealing. Treas. Reg. § 53.4941(d)-2(c)(1) further provides that an act of self-dealing occurs "where a note, the obligor of which is a Disqualified Person, is transferred by a third party to a Private Foundation which becomes the creditor under the note."

While transferring a Disqualified Person's promissory note directly to a Private Foundation would violate IRC § 4941(d)(1)(B) and Treas. Reg. § 53.4941(d)-2(c)(1) and thus be a prohibited act of self-dealing, because the LLC that the note is contributed to is not considered to be controlled by the Private Foundation under Treas. Reg. § 53.4941(d)-1(b)(5), which reads as follows:

> Control. For purposes of this paragraph, an organization is controlled by a Private Foundation if the foundation or one or more of its foundation managers (acting only in such capacity) may, only by aggregating their votes or positions of authority, require the organization to engage in a transaction which if engaged in with the Private Foundation would constitute self-dealing. Similarly, for purposes of this paragraph, an organization is controlled by a Private Foundation in the case of such a transaction between the organization and a Disqualified Person, if such Disqualified Person,

[285] IRS Notice 2012-52, PLR 200150027

> together with one or more persons who are Disqualified Persons by reason of such a person's relationship (within the meaning of section 4946(a)(1) (C) through (G)) to such Disqualified Person, may, only by aggregating their votes or positions of authority with that of the foundation, require the organization to engage in such a transaction. The "controlled" organization need not be a Private Foundation; for example, it may be any type of exempt or nonexempt organization including a school, hospital, operating foundation, or social welfare organization. For purposes of this paragraph, an organization will be considered to be controlled by a Private Foundation or by a Private Foundation and Disqualified Persons referred to in the second sentence of this subparagraph if such persons are able, in fact, to control the organization (even if their aggregate voting power is less than 50 percent of the total voting power of the organization's governing body) or if one or more of such persons has the right to exercise veto power over the actions of such organization relevant to any potential acts of self-dealing. A Private Foundation shall not be regarded as having control over an organization merely because it exercises expenditure responsibility (as defined in section 4945 (d)(4) and (h)) with respect to contributions to such organization. See example (6) of subparagraph (8) of this paragraph.

3. Taxpayers Can Now Rely Upon IRS Promulgated FAQs (Questions and Answers) To Avoid Penalties but Not Taxes and Interest

On October 15, 2021, the IRS issued a news release[286] in an attempt to address concerns regarding transparency, the potential impact of IRS-promulgated FAQs on taxpayers, and concerns regarding the application of penalties to taxpayers who rely on the FAQs.

This release states that taxpayers who "rely on any FAQ in good faith and [which] reliance is reasonable" will be allowed to have a reasonable cause defense against any negligence penalty or other accuracy-related penalty if the FAQ is later determined incorrect. Because this defense only applies to the negligence and other accuracy-related penalties, a taxpayer may still be liable for any unpaid tax liabilities, including interest on amounts owed, even if they do meet this reasonable cause standard.

However, it is important to note that the IRS was careful to add that "if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case, the law will control the taxpayer's tax liability", thus limiting the protection to just the negligence penalty.

Furthermore, the release states that "Rulings and Procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as

[286] *IRS Updates Process For Frequently Asked Questions On New Tax Legislation And Addresses Reliance Concerns*, I.R.S. (Oct. 15, 2021), https://www.irs.gov/newsroom/irs-updates-process-for-frequently-asked-questions-on-new-tax-legislation-and-addresses-reliance-concerns.

precedents." This too comes with a caveat: "In applying published Rulings and Procedures, the effect of subsequent legislation, regulations, court decisions, Rulings and Procedures must be considered."

While the release clarifies that taxpayers may use reasonable reliance on IRS FAQs as a defense, it does not address other sources of tax information promulgated by the IRS that taxpayers regularly use, such as tax form instructions and IRS Publications. The news release states that the FAQs are a "valuable alternative to guidance published in the Bulletin" as the justification for why taxpayers should be able to use the FAQs as a valid reasonable cause defense. The IRS apparently does not consider IRS Publications and tax form instructions to be "valuable alternatives" to the Internal Revenue Bulletin.

Additionally, the news release and the clarifying addition to the FAQ fact sheet are not authoritative guidance and can be revoked at any time. The following FAQ chart is provided to summarize the differences between various forms of IRS guidance.

Precedential (Posted in Bulletin)	**Non-precedential (Not Posted in Bulletin)**
Treasury Decisions	Private Letter Rulings
Executive Orders	FAQs[287]
Tax Conventions	Technical Advice Memoranda
Legislation	Field Service Advice Memoranda
Court Decisions	Chief Counsel Advice

4. <u>Is Form 1023 the Poor Person's Private Letter Ruling?</u>

Rev. Proc. 2023-1 recently increased the user fee for certain Private Letter Rulings from $30,000 to $38,000. However, taxpayers with gross income below $250,000 may be charged $3,000 for certain items.[288] Clients should know that it will typically take more professional time to apply for a PLR and interact with the IRS than to provide the same information in a Form 1023 Application for Tax Exempt Status (attached as Exhibit B).

Within fifteen months of formation (or longer with extension), a charitable organization must file a Form 1023 that describes the activities of the organization. While the approval of a Form 1023 that provides extensive disclosure of related party situations and issues is not necessarily binding upon the IRS, it can be received at very low cost compared to a Private Letter Ruling and may at least be indicative of what the Exempt Organization Division of the IRS will allow.

A PLR can take many months longer than obtaining approval under a Form 1023 and will receive significantly more scrutiny.

It is important to note that PLRs are only binding upon the IRS with respect to the specific taxpayer that applied for the ruling and based solely upon the specific facts presented. However,

[287] FAQs are subject to the safe harbor described above.
[288] *See* Exhibit A. "2021 Schedule of User Fees"

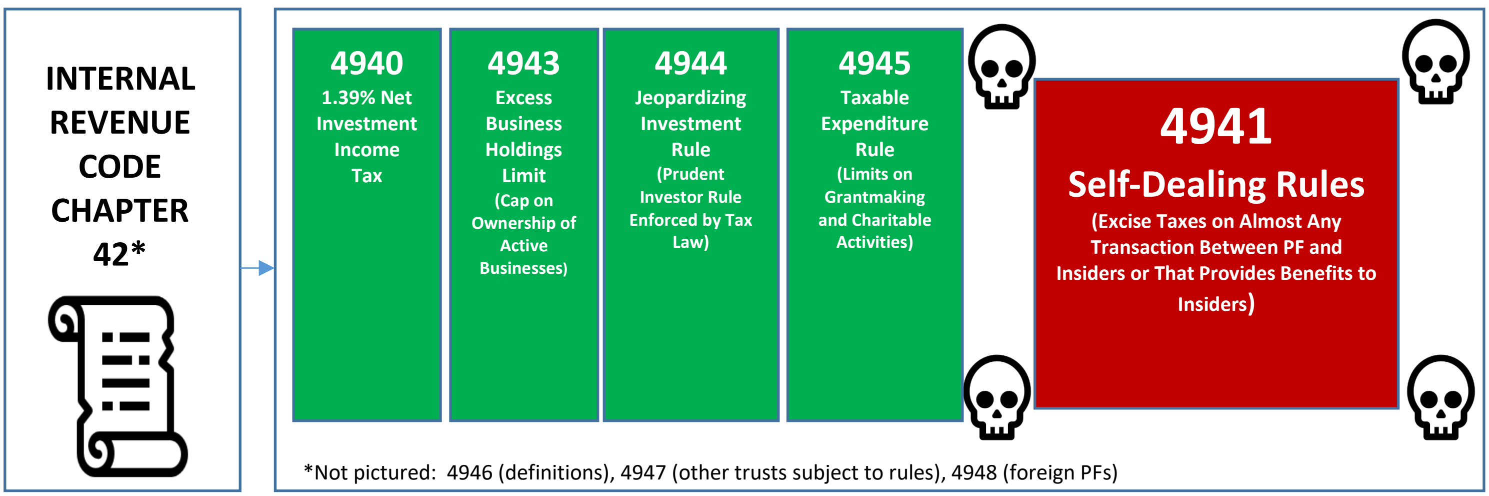
they usually provide safe pathways for advisors to follow when structuring their clients' charitable tax planning arrangements.

Additionally, the IRS's published instructions, guidance, and website information (other than FAQ's as described above) are not binding precedent upon the IRS, as stated in U.S. Tax Court opinion *Bobrow v. Comm'r*.[289] In *Bobrow*, the IRS published an obvious error in its guidance regarding IRA rollovers. Mr. Bobrow, an attorney specializing in tax law, relied upon the error and was penalized by the IRS for doing so.[290] The IRS had no mercy on Mr. Bobrow and took him all the way to the U.S. Tax Court to prove that a taxpayer who follows faulty IRS instructions cannot rely upon them.

Form 1023 is reproduced in Exhibit B of this book.

[289] 107 T.C.M. (CCH) 1110 (2014).
[290] IRS Publication 590 and proposed income tax regulations, the guidance Mr. Bobrow relied upon, interpreted the "One-Per-Year" IRA rollover limitation in I.R.C. § 408(d)(3)(B) to apply to each IRA a taxpayer owns, as opposed to the court's interpretation that the limitation only allows a taxpayer to make one rollover per year, regardless of how many IRAs the taxpayer owns.

CHAPTER 4:
WALLS AND BRIDGES:[291] CHARITABLE ORGANIZATION, DONATION, AND CONDUCTION LIMITATIONS AND SOLUTIONS



A. Self-Dealing (IRC § 4941)

Self-dealing is defined by IRC § 4941 as a direct or indirect transaction that occurs between a Disqualified Party, person, or entity, and a Private Foundation. For the purposes of this rule, Private Foundations include both Private Operating Foundations and Private Non-Operating Foundations.

This section will review the significant exceptions for interest-free loans, rent-free use of property, and fair market value payment for "white collar" services, as well as the complicated attribution rules that can cause relatives, co-owners of business entities themselves, and also estates and trusts to be aggregated and inadvertently trigger this up to 265% initial and then reoccurring tax that can be imposed upon innocent and well-meaning conduct that actually helps the foundation.

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[291] *Walls and Bridges* was John Lennon's fifth studio album, featuring the singles, "Whatever Gets You thru the Night" and "#9 Dream."

IRC § 4941(d)(1) provides that the following transactions constitute Self-Dealing. The items in the right column are prominent exceptions thereto:

(A) sale or exchange, or leasing, of property between a Private Foundation and a Disqualified Person;	Allowing a Private Foundation to use office space or equipment without any cost is permitted.
(B) lending of money or other extension of credit between a Private Foundation and a Disqualified Person;	Loans at 0% interest from a disqualified person to a Private Foundation are permitted.
(C) furnishing of goods, services, or facilities between a Private Foundation and a Disqualified Person;	A private foundation can directly pay its share for shared goods, services, or facilities.
(D) payment of compensation (or payment or reimbursement of expenses) by a Private Foundation to a Disqualified Person;	Certain services provided by disqualified individuals can be compensated for by a Private Foundation.
(E) transfer to, or use by or for the benefit of, a Disqualified Person of the income or assets of a Private Foundation; and	
(F) agreement by a Private Foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.	

The above rules do not permit a sale of assets between a Private Foundation and a Disqualified Person, or the payment of any rent or interest by the charity to a Disqualified Person, even if the rent or interest is set well below fair market value. Further, a Disqualified Person is not permitted to directly or indirectly benefit from a 501(c)(3) organization if this would arise to the level of violating the "private inurement" rules described in Chapter 2.

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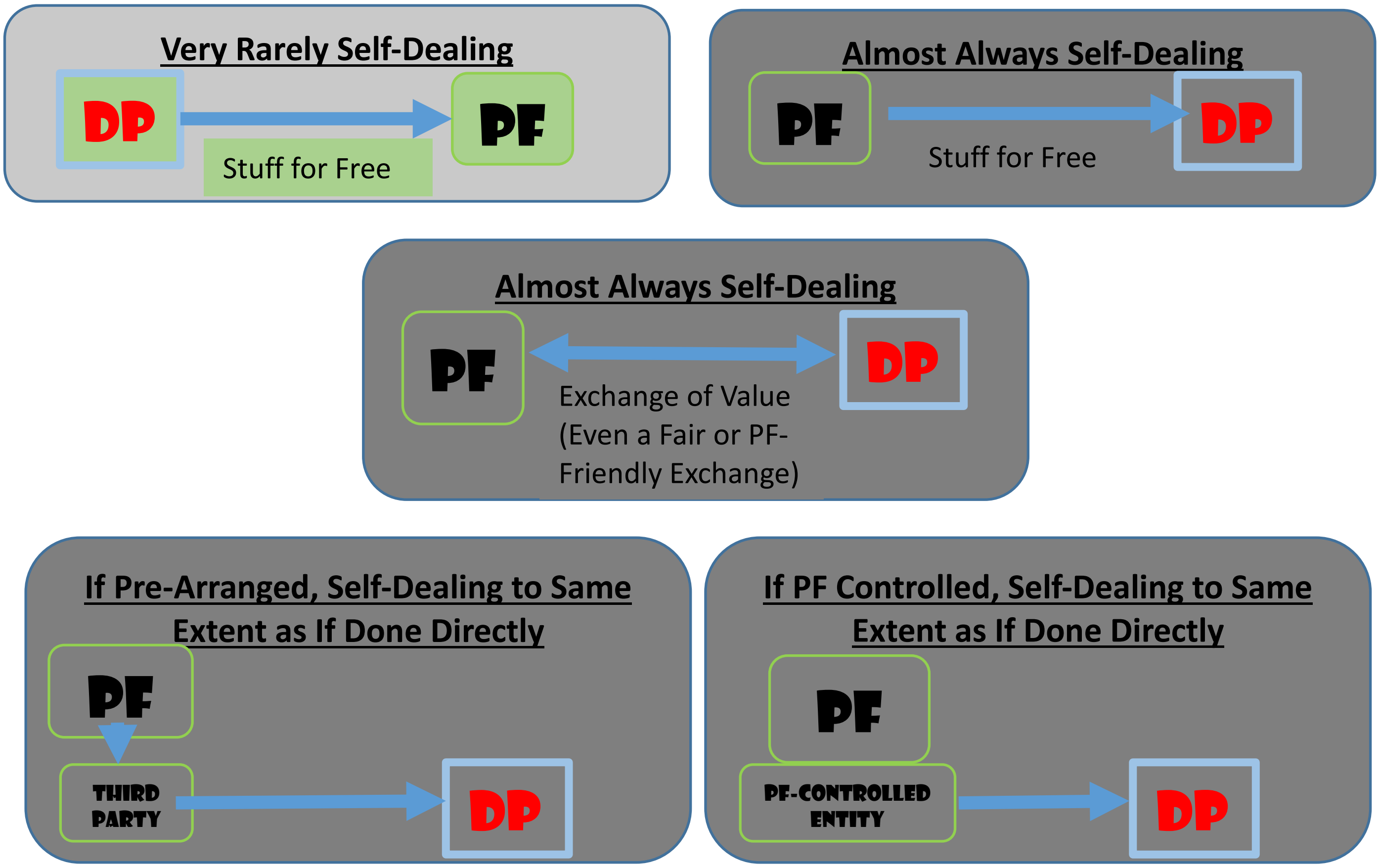
Acts of Self-Dealing

Specifically defined in 4941(d):
Most transactions involving a private foundation and a disqualified person, whether directly OR indirectly.



1. Direct Self-Dealing

Direct self-dealing occurs when a transaction is made directly between a Private Foundation and a Disqualified Person. An example of this would be a Disqualified Party lending money directly to the foundation.

It is irrelevant whether the transaction benefits or harms the Private Foundation or whether the transaction is a "good deal" for the Private Foundation. For example, the sale of an office building worth $100,000 from a Disqualified Person to a Private Foundation for $1 is an act of self-dealing, regardless of the fact that the Private Foundation is purchasing the building for 1/100,000 of its value.

Acts of Self-Dealing

Specifically defined in 4941(d): Most transactions involving a private foundation and a disqualified person, whether directly OR indirectly.

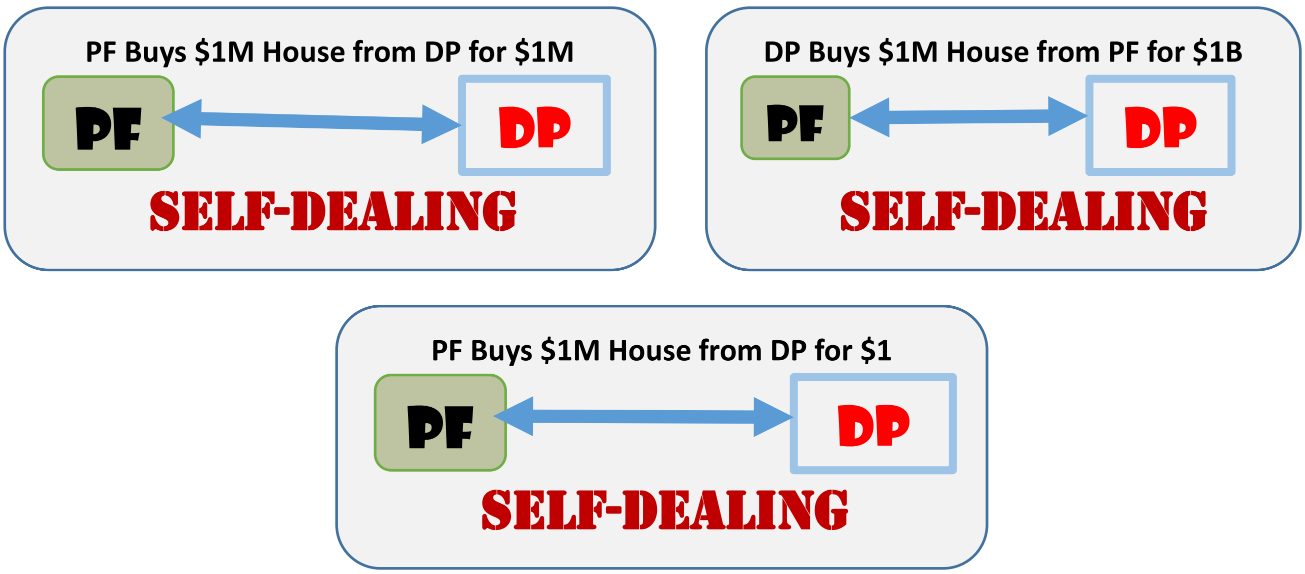
IRC § 4941(d)(1) provides that the following transactions between a Private Foundation and a Disqualified Person are acts of self-dealing:

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;

(B) lending of money or other extension of credit between a private foundation and a disqualified person;

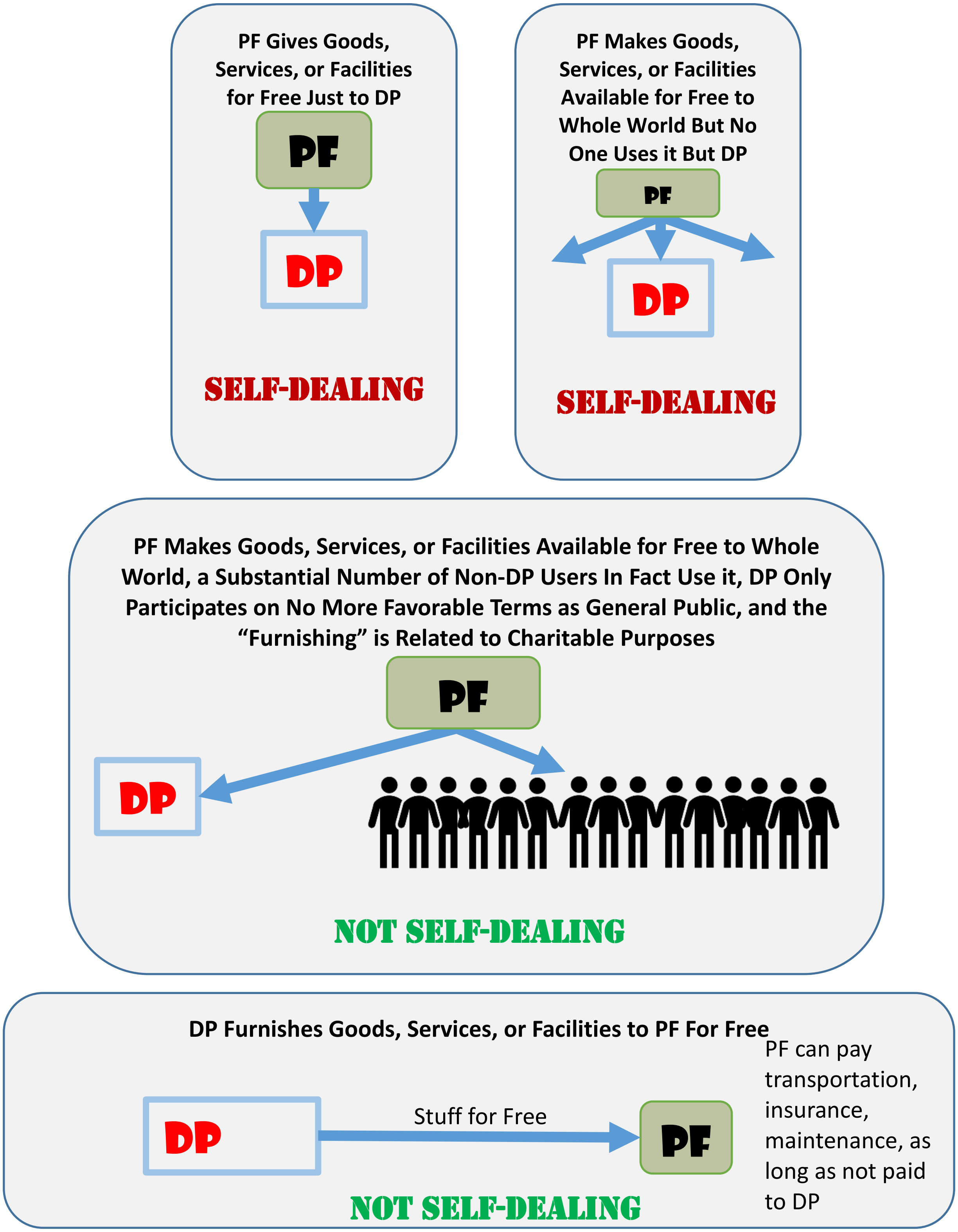
Generally, a donation of cash or unencumbered property (see Section C for a discussion of donations of encumbered property) from a Disqualified Person to a Private Foundation is not an act of self-dealing. It is also noteworthy that a charitable pledge made to a Private Foundation may implicate the self-dealing rules, although the making of a pledge by a disqualified person to a Private Foundation without more is not considered to be an act of self-dealing. [292]

Sale, Exchange, or Leasing Between a PF and a DP



[292] Treas. Reg. 53.4941(d)-2(c)(3) (as amended in 1995).

Furnishing of Goods, Services, or Facilities Between a PF and a DP



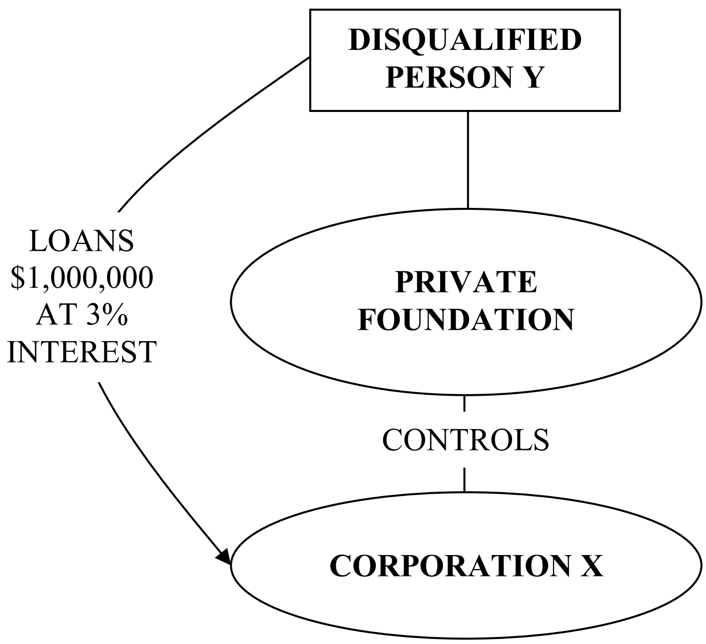
2. Indirect Self-Dealing

Indirect self-dealing occurs when a transaction is made between a Disqualified Person and a person or organization that is owned, controlled, or related by attribution to a Private Foundation.

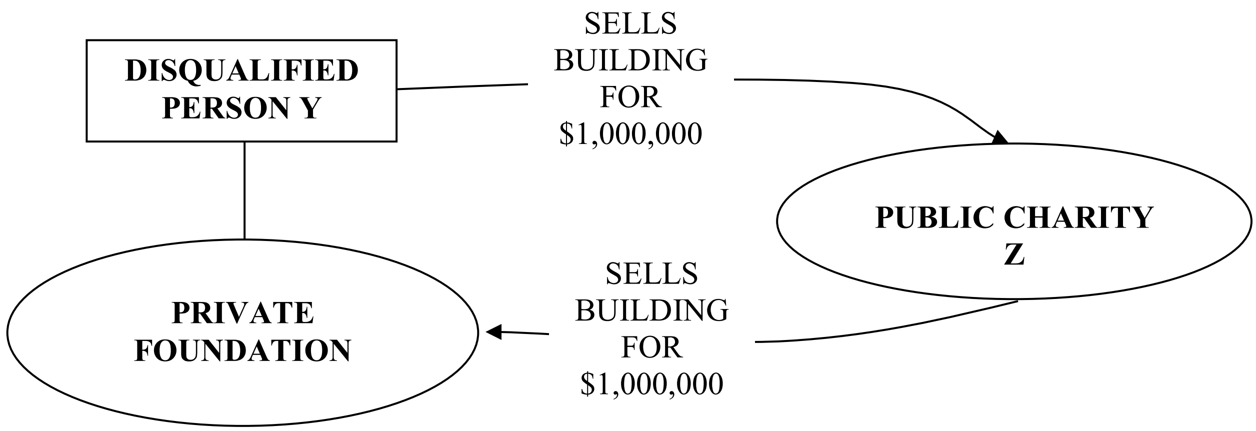
Generally, if a transaction would be an act of self-dealing under the list of direct acts enumerated above, then it is an act of indirect self-dealing to engage in the transaction via an intermediary.

The following examples may be useful:

Example 1: Y is a Disqualified Person with respect to Private Foundation. Corporation X is a corporation that Private Foundation controls. Y loans Corporation X $1,000,000 at a 3% interest rate. This would be an example of indirect self-dealing because, although the foundation is not directly involved in the transaction, the foundation controls Corporation X.

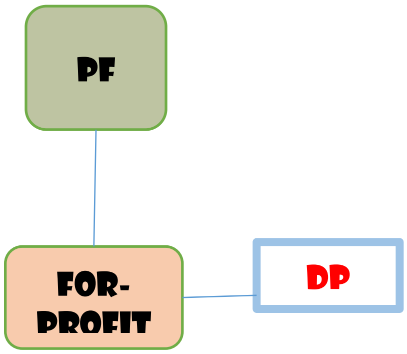


Example 2: Y is a Disqualified Person with respect to Private Foundation. Foundation Z is a Public Charity that is unrelated to both Y and the Private Foundation. Y sells a building to Public Charity X for $1,000,000 with the unwritten understanding that Public Charity X will in turn sell the building to the Private Foundation for $1,000,000. This would be an example of indirect self-dealing because the sale of the building to the Private Foundation would be an act of self-dealing if done directly by Disqualified Person Y. A Disqualified Person cannot make an agreement (even if only verbal or simply an understanding) with a third party to enter into a transaction with a Private Foundation if the transaction would be an act of self-dealing if done directly by the Disqualified Person.


DISQUALIFIED PERSON Y
SELLS BUILDING FOR $1,000,000
PUBLIC CHARITY Z
SELLS BUILDING FOR $1,000,000
PRIVATE FOUNDATION

Indirect Self-Dealing

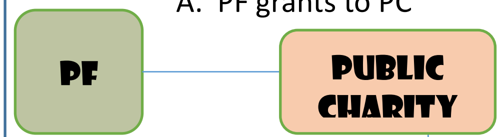
1. Controlled Entities



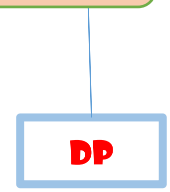
If PF "controls" the for-profit, then the for-profit needs to follow the self-dealing rules, and these transactions with the DP are potentially indirect self-dealing.
Definition of "control" is nuanced (aka subject to clever planning), see Rev. Rul. 80-207

2. Intermediaries

A. PF grants to PC

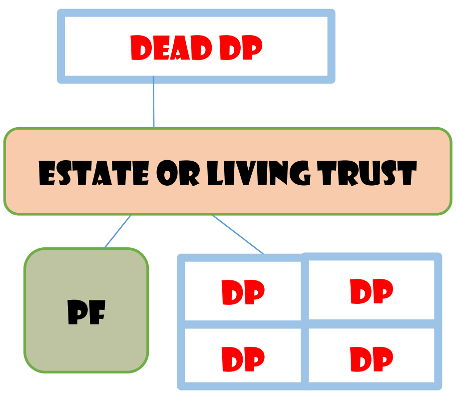


B. PC uses funds to enter transaction with DP that would have been self-dealing if the PF did it.



If there is an agreement by which the public charity will enter into the transaction with a disqualified person as a condition of the agreement (whether written or verbally), the transaction is STILL treated as an act of self-dealing.
CAUTION: the IRS has found indirect self-dealing when there was NO binding/enforceable agreement for the intermediary to enter into the 2nd transaction—an understanding can be enough.

3. Estates



VERY common context for indirect self-dealing. See *Rothko* estate cases.
If private foundation is a beneficiary (i.e. assets are unreservedly destined for the foundation), the Estate's dealings with disqualified persons all carry self-dealing potential (e.g. a settlement of a dispute, a sale that results in a promissory note).

3. Disqualified Person (IRC § 4946)

A Disqualified Person is any individual or entity that may have an excessive influence on a Private Foundation. IRC § 4946(a)(1) defines a Disqualified Person as any one or more of the following:

Disqualified Persons	Definition
All **substantial contributors** to the Private Foundation	A substantial contributor is a person who has contributed a total of more than $5,000 in total to the Private Foundation (in a year) if the amount is more than 2% of the total contributions received for the tax year.
All **managers** of the Private Foundation	A manager is any officer, director, or trustee of a foundation, or any individual having powers or responsibilities similar to those held by officers, directors, or trustees of the foundation.
Owners of more than 20% of entities that are substantial contributors to the Private Foundation	An owner is anyone who has a spine more than 20% of: (a) the combined voting power of a corporation, (b) the profits interest of a partnership, or (c) the beneficial interest of a trust or unincorporated enterprise.

<table>
<tr><th>Disqualified Persons</th><th>Definition</th></tr>
<tr><td>Family members of any disqualified person</td><td>The definition of “family member” only includes a disqualified person’s:
i. spouse,
ii. children, and
iii. parents.

The definition does not include a disqualified person’s:
i. stepparents,
ii. stepchildren,
iii. sons-in-law and daughters-in-law,
iv. grandparents,
v. siblings,
vi. nephews and nieces, and
vii. close friends and significant others.
viii. ex-spouse

This assumes that such “more distant” family members are not otherwise affiliated by related-party ownership, because they are:

a) substantial contributors to the Foundation,

b) managers of the Foundation, or

c) owners of more than 20% of entities that are substantial contributors to the Private Foundation.

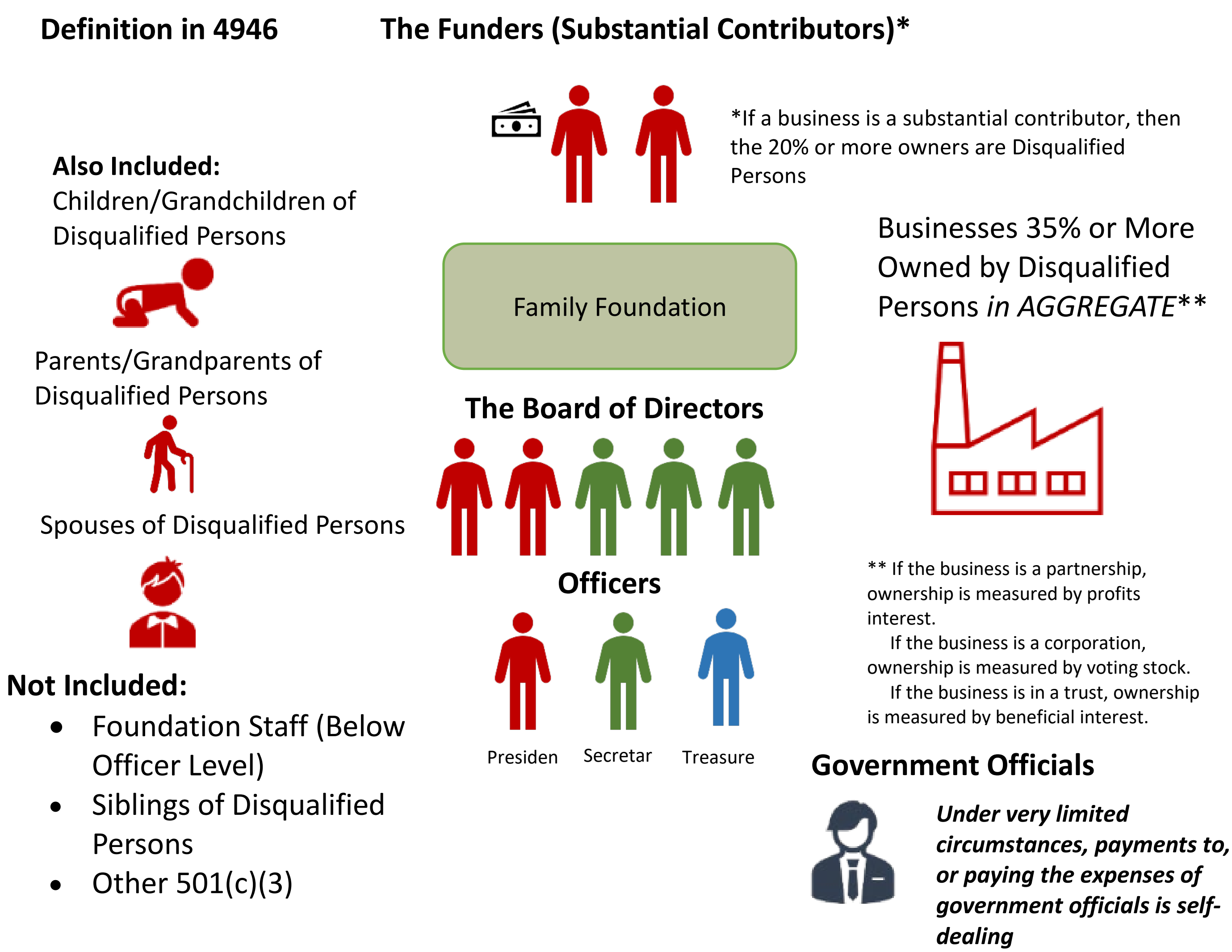
See the section on 35/65 Trusts in Chapter 4 for a discussion of how a trust that may benefit family members as to 35% or less and others as to 65% or more can be used to avoid the self-dealing rules.</td></tr>
<tr><td>Corporations, partnerships, trusts, and estates that are more than 35% owned by disqualified persons</td><td>Corporation ownership is measured by total combined voting power.

Partnership ownership is measured by profits interest.

Trust or estate ownership is measured by beneficial interest.</td></tr>
</table>

Disqualified Persons	Definition
Government officials who make a direct or indirect agreement to receive money from a Private Foundation. Note that such an agreement is an act of self-dealing. (This does not prohibit an agreement to be employed by a Private Foundation after the official's government service is terminated—if the official is terminating his or her government employment within 90 days.)	• Federal elected officeholders, • Positions appointed by the President, • Schedule C federal employees, • House and Senate staffers who receive more than $15,000 compensation annually, • Any other elected or appointed public officeholder who receives more than $20,000 in compensation annually, • A personal or executive assistant of any of the previously mentioned officials, and • Members of the IRS Oversight Board

Disqualified Persons



The law also prohibits these Disqualified Persons from holding what is referred to as "an excess amount" of stock or interest in an entity for the purposes of the Excess Business Holding Rules, as discussed in Section D below.

4. <u>The Self-Dealing Penalties</u>

The harsh penalties that apply for an act of self-dealing are as follows:

a. An excise tax equal to 10% of the amount involved in the self-dealing transaction will be imposed on the Disqualified Person participating in the self-dealing.

b. An excise tax equal to 5% of the amount involved in the self-dealing transaction will be imposed on the foundation manager if the foundation manager knowingly engaged in such acts. This penalty shall not exceed $20,000.

c. An additional excise tax equal to 200% of the transaction amount will be imposed on the Disqualified Person if the Disqualified Person does not correct the self-dealing issue within the taxable period in which the act of self-dealing occurred.

d. An additional excise tax equal to 50% of the transaction amount will be imposed on the foundation manager if the foundation manager does not correct the self-dealing issue within the taxable period in which the act of self-dealing occurred.

IRC § 4941(e)(1) provides that a "taxable period" with respect to an act of self-dealing begins on the date of the act of self-dealing and ends on the earliest of:

(A) The date of mailing a notice of deficiency,

(B) The date on which the 10% excise tax on the Disqualified Person is assessed, or

(C) The date on which correction of the act of self-dealing is completed.

5. Prominent Exceptions to the Self-Dealing Rules

1. Personal Services Exception

The self-dealing rules include an exception that permits a Private Foundation to pay compensation to a Disqualified Person (other than a government official) for personal services rendered to the Private Foundation.[293] As the United States Tax Court acknowledged in 1983 in *World Family Corp. v. Commissioner*, "[t]he law places no duty on individuals operating charitable organizations to donate their services; they are entitled to reasonable compensation for their efforts."[294]

a. The Services

The services rendered by the Disqualified Person (who does not have to be an individual) must be:

1. Personal services (the examples given in Treasury Regulation 53.4941(d)-3(c) and listed under "Examples" below indicate that generally "white collar" services—such as legal, investment, banking, and broker services—are

[293] I.R.C. § 4941(d)(2)(E).
[294] 81 T.C. 958, 969 (1983).

personal services, while "blue collar" services—such as manufacturing, maintenance, and janitorial services—are not),

2. Reasonable,

3. Necessary to carrying out the exempt purpose of the Private Foundation, which can include permitted investment activities, and

4. Executive and professional in nature as opposed to being "blue collar," as described below.

b. The Compensation

The compensation must not be excessive but must instead be "reasonable and true compensation" for the personal services rendered.[295] Treasury Regulation § 1.162-7 defines "reasonable and true compensation" as "only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned."

The compensation may include the payment or reimbursement of expenses and the Private Foundation can make "advances for expenses anticipated in the immediate future. . . so long as the amount of the advance is reasonable in relation to the duties and expense requirements of the foundation manager. . . . [S]uch advances shall not ordinarily exceed $500."[296]

c. Examples

Because the term "personal services" is not defined in the code, we must rely on the examples given in the Regulations and Private Letter Rulings to define the term. Private Letter Rulings are binding on the IRS only as to the taxpayer for whom they are written but are typically used as guideposts. These particular Private Letter Rulings in this area have not been criticized by commentators and seem to be reliable guidelines.

In Private Letter Ruling 9325061, the IRS emphasized that the personal services exception "should be strictly construed." Treasury Regulations, IRS Private Letter Rulings, and Tax Court Rulings provide the following examples of services and compensation that are or are not personal services. Although the list is not exhaustive, it is illustrative of the general type of services that qualify as personal services.

Services that are permitted personal services include the following:

[295] I.R.C. § 4941(d)(2)(E); Treas. Reg. § 1.162-7 (1960).
[296] Treas. Reg. § 53.4941(d)-3 (as amended in 1984).

- Brokerage services;[297]

- "[P]erformance by a bank or trust company which is a Disqualified Person of trust functions and certain general banking services for a Private Foundation;"[298]

- "[P]ayment . . . made to [a] law partnership, not the lawyer who performed the legal services;"[299]

- "[P]ayment of premiums for an insurance policy purchased to indemnify a Disqualified Person against any claims in connection with an SEC registration with which the Disqualified Person assisted;"[300]

- Payments to attorney "[w]here director sued other directors to require them to carry out the foundation's charitable program, which had become inactive;"[301]

- "[P]rogram-related consulting provided to other charities . . . and . . . investment consulting provided to other charities;"[302] and

- "[L]easing of real property to a Disqualified Person who was to be the Private Foundation's on-site representative."[303]

Services that are **not** personal services for the purposes of the self-dealing rules include "blue-collar" and related services that have been identified as including the following:

- "[M]aintenance, janitorial, and security services;"[304]

- Payments for property (as opposed to being a payment for services);[305]

[297] Treas. Reg. § 53.4941(d)-3 (as amended in 1984).
[298] Treas. Reg. § 53.4941(d)-2 (as amended in 1995).
[299] Dean Robert J. Desiderio & Patricia A. Tyler, *Lexis Explanation IRC Sec. 4941(d)*, *in* Lexis IRC (Internal Revenue Code) Explanations (2022) (citing Treas. Reg. § 53.4941(d)-3(c)(2), Ex. (1) (as amended in 1984)).
[300] Dean Robert J. Desiderio & Patricia A. Tyler, *Lexis Explanation IRC Sec. 4941(d)*, *in* Lexis IRC (Internal Revenue Code) Explanations (2022) (citing Rev. Rul. 74-405, 1974-2 CB 384).
[301] 26 U.S.C.S. § 4941 (LexisNexis, Lexis Advance through Public Law 117-130, approved June 6, 2022) (citing Rev. Rul. 73-613, 1973-2 C.B. 385).
[302] I.R.S. Priv. Ltr. Rul. 201937003 (Mar. 13, 2019).
[303] Dean Robert J. Desiderio & Patricia A. Tyler, *Lexis Explanation IRC Sec. 4941(d)*, *in* Lexis IRC (Internal Revenue Code) Explanations (2022) (citing I.R.S. Priv. Ltr. Rul. 9327082 (Apr. 14, 1993)).
[304] Michael V. Bourland et al., *Estate Planning for the Family Business Owner 2020 -- Part 2 TAX STRATEGIES IN LIGHT OF LOSSES*, *in* ALI CLE Course of Study - Estate Planning for the Family Business (2020) (citing *Madden v. Comm'r*, 74 T.C. Memo. 1997-395 (1997)).
[305] I.R.S. Priv. Ltr. Rul. 9325061 (Apr. 1, 1993), citing Treas. Reg. § 53.4941(d)-3(c)(2).

- Furnishing or manufacturing a product;[306]
- "[T]he services of a dealer who buys from the Private Foundation as principal and resells to third parties;"[307]
- "[B]elow commercial-interest-rate home mortgage loan to a prospective foundation manager offered as part of a compensation package;"[308] and
- "[A] 'conglomerate' of real estate management, brokerage, construction, marketing and advertising, and insurance brokerage services."[309]

While the above lists are instructive and help to categorize most transactions, certain transactions are more difficult to categorize because they combine a personal service with the rental of property. An example is a charter aircraft company renting a charter aircraft with a pilot to a Private Foundation, of which the company is a Disqualified Person. The rental of the aircraft that is reasonably necessary for the operation of a Foundation would not be a personal service,[310] but it is not clear whether the service of the pilot would qualify as a personal service in this combined transaction.[311]

2. Interest-free Loan Exception

It is not considered to be an act of self-dealing for a Disqualified Person to loan funds to a Private Foundation at a 0% interest rate, with no charges imposed on the borrower. In addition, the foundation must use these funds to carry out its exempt purpose.

As mentioned above, it is also generally not an act of self-dealing for a Disqualified Person to donate cash or unencumbered property to a Private Foundation.

3. Rent-free Use and Sharing Leasehold Expenses

A Disqualified Person may lease real estate and office spaces to a Private Foundation without it being considered an act of self-dealing so long as this is free of charge.

Although Private Foundations are not permitted to make rent payments to a Disqualified Person, they may still make payments toward related services such janitorial, utilities, or other maintenance costs, so long as they are not paid directly or indirectly to a Disqualified Person. If a Disqualified Person pays these expenses and then is reimbursed, then the exception may not apply because the services are not "Personal Services" as described in

[306] I.R.S. Priv. Ltr. Rul. 9325061 (Apr. 1, 1993), citing Treas. Reg. § 53.4941(d)-3(c)(2).
[307] Treas. Reg. § 53.4941(d)-3 (as amended in 1984).
[308] I.R.S. Priv. Ltr. Rul. 9530032 (May 3, 1995).
[309] Berry and Kawashima, *I. Introduction, A. Self-Dealing Identification Checklist*, *in* 470-2nd T.M., Private Foundations — Self-Dealing (Section 4941) (citing I.R.S. Priv. Ltr. Rul. 9325061 (Apr. 1, 1993)).
[310] Rev. Rul. 73-363, 1973-2 CB 383.
[311] *Lexis Explanation I.R.C. Sec. 4941(d)*. This example assumes that a Private Foundation can justify the use of a charter airplane, such as if it transports advisors, products, and/or orphans to a foreign country to help needy people.

Section 1 above! Payments are also permitted to be made by the organization for the cost of leased office equipment, so long as it is divided appropriately by its use. Treas. Reg. § 53.4941(d)-2(b)(2) provides:

> The leasing of property by a Disqualified Person to a Private Foundation shall not be an act of self-dealing if the lease is without charge. . . . [A] lease shall be considered to be without charge even though the Private Foundation pays for janitorial services, utilities, or other maintenance costs it incurs for the use of the property, so long as the payment is not made directly or indirectly to a Disqualified Person.

4. <u>Corporate Redemption Exception</u>

IRC § 4941(d)(2)(F) allows for a company partly owned by a Foundation to pay the Foundation in assets or monies in exchange for its ownership interest, and also allows a company partly owned by a Foundation to give money or assets to a Disqualified Person in exchange for ownership of the company. The statute provides that "any transaction between a private foundation and a corporation which is a disqualified person . . . pursuant to any liquidation, merger, redemption, or other corporatize adjustment, shall not be an act of self-dealing if":

- "[A]ll of the securities of the same class as that held by the foundation are subject to the same terms," and

- "[S]uch terms provide for receipt by the foundation of no less than fair market value."

While this exception references transactions between "a Private Foundation and a corporation" and makes no reference to a partnership, the IRS allowed this exception to include partnerships structured similarly to a corporation in Private Letter Rulings 9237032 (June 16, 1992) and 20015007 (Aug. 22, 2001).

5. <u>The "Estate Exceptions"</u>

There are two exceptions that help enable estates to transfer assets to or transact with Foundations, although narrow trails will often need to be walked in order to comply with the rules.

These are the Estate Administration Exception and the First-Bite Rule:

a. The Estate Administration Exception

Self-dealing will not occur with respect to transactions between a Private Foundation's interest or expectancy in property held by an estate (or revocable trust), regardless of when title to the property vests if all of the following requirements are met:[312]

[312] Treas. Reg. § 53.4941(d)-1(b)(3) (as amended in 1973).

i. The administrator or executor possesses a power of sale of the property, has the power to reallocate the property to another beneficiary, or is required to sell the property;

ii. The transaction is approved by a probate court with jurisdiction;

iii. The transaction occurs before the estate is considered to be terminated for federal income tax purposes;

iv. The estate receives an amount which is equal to or exceeds the fair market value of the foundation's interest or expectancy in such property; and

v. The transaction is required under the terms of any option which is binding on the estate or trust, results in the foundation receiving an interest or expectancy that is at least as liquid as the one it gave up, or results in the foundation receiving an asset relating to the carrying out of its exempt purposes.

It should be noted that the IRS has stated that it will no longer issue Private Letter Rulings or determination letters as to whether an asset is more liquid than the interest or expectancy that the foundation is giving up.

Note as well that the second requirement to qualify for this exception requires an order from a probate court with jurisdiction. This exception does not apply without a court order.

b. Death and The First-Bite Rule

A transaction that occurs between a Private Foundation and a Disqualified Person will not be classified as an act of self-dealing if the status of Disqualified Person arises only as a result of such transaction.[313]

For example, if an individual has set up a Private Foundation but has not yet made any contributions to the foundation, he or she will not be classified as a Disqualified Person with respect to that foundation.

It would typically be considered to be an act of self-dealing if this individual funded the Private Foundation using mortgaged property that is less than 10 years old. However, because this individual is not yet a Disqualified Person, he or she may contribute the mortgaged property without committing an act of self-dealing.

The individual will have made a substantial contribution and will now be classified as a substantial contributor. This means that if the individual has another mortgaged property that he or she would like to contribute to the foundation at a later date, doing so will be an act of self-dealing because he or she is already a Disqualified Person.

[313] Treas. Reg. § 53.4941(d)-1(a) (as amended in 1973).

c. Exceptions for Transfers from Decedents

While a decedent and his or her estate and revocable trust are considered to be Disqualified Persons who could not typically transfer property in exchange for a debt, there is support for the proposition that an estate is not a Disqualified Person until it has become a substantial contributor to the Private Foundation. Furthermore, because of the first-bite rule, an estate will generally not be a Disqualified Person at the time of the first transfer from the estate to the Private Foundation.

This exception does not exist for donors who are living. General Counsel Memorandum 39445 (Nov. 12, 1985) indicates that an estate is not a Disqualified Person within the meaning of section 4946 merely because the decedent was a Disqualified Person. An estate is only a Disqualified Person if it qualifies on its own regard (i.e., becomes a substantial contributor).

Therefore, to avoid committing an act of self-dealing, the estate must make the real estate contribution the first and only transfer to the Private Foundation. Arguably, a trust distribution is not a "contribution." Even if it is, the first-bite rule indicates that the first transfer is not an act of self-dealing.

If the donor is not yet a director or officer, then the only reason they would be a Disqualified Person is as a substantial contributor. The "first bite" rule says that the gift that makes you a substantial contributor cannot be an act of self-dealing -- so if you're going to donate encumbered real property to a charity, do it all at once as your first gift and do not be a director/officer/trustee.

CAUTION: If a bargain sale between a Disqualified Person and a Private Foundation involves debt, the Disqualified Person is considered to have sold a portion of the property and has thereby committed an act of self-dealing. An exception must apply or there can be significant penalties and problems.

6. The 35/65 Trust Exception

IRC § 4946(a)(1)(G) provides that certain trusts and estates that have 35% or less of their beneficial interest held by Disqualified Person(s) will not be classified as disqualified by reason of such beneficial interest. Therefore, a family wishing to control an entity partly owned by a charity of which they are Disqualified Persons can place all of the voting interests in the investment or business entity under a trust under which up to 35% of its beneficial interest is held for Disqualified Persons, and 65% of which is held for individuals or entities that are not Disqualified Persons.

Under this exception, an individual or individuals who are considered to be "Disqualified Persons" may serve as the trustees of a trust that benefits individuals or entities, as long as the possible benefits to be paid to family members do not exceed 35% of the cumulative benefits paid from the trust holding such voting interest.

In order to prevent such a "voting stock trust" from being treated as a separate charitable organization (which would cause the trust itself to be treated as a Private Foundation), at least some of the beneficiaries should be individuals or organizations that are not considered to be charities as defined in IRC § 170(c)(2)(B). This can include close friends or employees who are not related by family relationship to the donor's family under IRC § 267(b), IRC § 501(c)(4) social wealth organizations and cemetery associations, or other non-charitable entities that the grantor of the trust may wish to benefit. It is noteworthy that S corporation stock may be held under a trust that benefits only individuals and 501(c)(3) charities.

The actual language of IRC § 4946(a)(1)(G) is as follows:

> (a) Disqualified Person
>
> (1) For purposes of this subchapter, the term "Disqualified Person" means, with respect to a Private Foundation, a person who is –
>
> > . . . (G) a trust or estate in which [Disqualified Persons] own more than 35 of the beneficial interest.

Some advisors believe that such a trust should be taxed as a complex trust and not designed to be disregarded for income tax purposes because the definition of the word "trust" in this statute is not defined.

Others believe that this is not necessary because the definition of a trust in the Internal Revenue Code includes a grantor trust that is disregarded for income tax purposes under IRC § 671, which reads as follows:

> Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual.

7. Self-Dealing Rules on Mortgaged Property and Exceptions Thereto

Many donors would like to transfer property subject to a mortgage or other encumbrance to charity. These transfers may be considered the equivalent of a bargain sale because the charity is assuming the debt. While this may not be a problem for those contributing mortgaged property to a Public Charity, because this will be classified as a sale/exchange, Disqualified Persons wishing to contribute mortgaged property to a Private Foundation will run into self-dealing restrictions.

It is noteworthy that similar rules and similar but not identical exceptions apply with respect to the unrelated taxable income rules, as per the chart below.

Common Exceptions to Self-Dealing and UBTI			
Self-Dealing Exceptions		**UBTI Exceptions**	
Exception	**Effect**	**Exception**	**Effect**
The 10-Year Rule	Allows a disqualified person to transfer mortgaged property to a Private Foundation without it being treated as a sale/exchange if the mortgage was placed on the property at least 10 years prior to the transfer.	**The 5/5 Rule (Mortgaged Property)**	Will not treat mortgaged property acquired by an organization by gift as an acquisition of indebtedness during the 10 years following the date of gift if: (1) donor held property for more than 5 years, and (2) Mortgage was placed on property more than 5 years before gift.
First Bite Exception	A transaction that occurs between a Private Foundation and a Disqualified Person will not be classified as an act of self-dealing if the status of Disqualified Person arises only as a result of such transaction.	**Bequest or Devise (Mortgaged Property)**	Will not treat mortgaged property acquired by an organization by way or bequest or devise as an acquisition of indebtedness during the 10 years following the date of acquisition.
Corporate Redemption Exception	Transaction between a Private Foundation and corporation that is a Disqualified Person is not self-dealing if pursuant to redemption as long as: (1) all securities of the same class as the Private Foundation are subject to the same terms and (2) terms provide the Private Foundation no less than fair market value.	**Interest and Dividends**	IRC § 512 excludes all dividends, interest, and payments with respect to securities loans, amounts received or accrued as consideration for entering into agreements to make loans, and annuities, and all deductions directly connected with such income.

Common Exceptions to Self-Dealing and UBTI			
Self-Dealing Exceptions		UBTI Exceptions	
Exception	Effect	Exception	Effect
Estate Administration Exception	Self-dealing will not occur with respect to transactions between Private Foundation's interest in property held by an estate if: (1) executor possess power of sale, (2) transaction approved by probate court, (3) transaction occurs before estate is considered terminated, (4) estate receives at least FMV, (5) PF receives an interest at least as liquid as the one given up.	**Rents Derived from Real Estate**	Rents from real property and the deductions directly connected with the real property are excluded from UBTI. However, should not be debt-financed properties.
35/65 Trust	Trusts that provide for no more than 35% of its beneficial interest to a disqualified will not be considered a Disqualified Person. Therefore, a 35/65 Trust may enter into transactions with a Private Foundation that a Disqualified Person would otherwise not be permitted to enter.	**Royalties**	Royalties received shall be excluded from UBTI. Must be related to trademarks, trade names, service marks, or copyrights
Interest Free Loans	It is not considered an act of self-dealing for a Disqualified Person to loan funds to a Private Foundation so long as the Disqualified Person does so at a 0% interest rate and no other charges are imposed on the borrower. These loaned funds must be used to carry out the Private Foundation's exempt purpose.	**Income from Certain Research Activities**	All income derived from research for the United States, or any of its agencies or instrumentalities, or any state or political subdivision shall be excluded from UBTI.

Common Exceptions to Self-Dealing and UBTI			
Self-Dealing Exceptions		UBTI Exceptions	
Exception	Effect	Exception	Effect
Personal Service Exception	Disqualified Persons may receive reasonable compensation for personal services rendered to the Private Foundation so long as the services are reasonable and necessary to carrying out the foundation's exempt charitable purpose.		
Rent-Free Use and Sharing Leasehold Expenses	A Disqualified Person may lease their real estate and office spaces to Private Foundation without it being considered an act of self-dealing so long as it is being done free of charge. However, the organizations may make payments toward related services such as janitorial, utilities, and other maintenance costs so long as not paid directly or indirectly to Disqualified Persons.		

However, there are three primary exceptions that may allow a Disqualified Person to contribute property subject to debt to a Private Foundation:

1. <u>The 10-Year Rule</u>

IRC § 4941(d)(2)(A) provides that contributions of mortgaged property will not be viewed as a sale or exchange if the Disqualified Person has placed the mortgage or lien on the property longer than 10 years before the transfer. Therefore, a Disqualified Person may transfer mortgaged property to a Private Foundation without violating the self-dealing rules if the mortgage is older than 10 years.

It should be noted that if the Disqualified Person has refinanced the property within those 10 years, it is not considered to be new debt so long as the principal of the debt has not increased.[314] Therefore, to the extent that the outstanding principal does not increase, a refinance will be considered a continuation of a preexisting debt.

2. The Received Upon Death Exception

Where property subject to a mortgage is acquired by bequest or devise resulting from death, the pre-death principal indebtedness secured by such mortgage is not treated as acquisition indebtedness during the 10-year period following the date that the organization receives the property.

3. The Received by Gift and 5 Year Mortgaged / 5 Year Owned Exception

If an organization acquires property by gift subject to a mortgage, the outstanding principal indebtedness secured by such mortgage is not treated as acquisition indebtedness during the 10-year period following the date of such gift if the following has occurred:

- The mortgage was placed on the property more than 5 years before the date of the gift, and

- The property was held by the donor for more than 5 years before the date of the gift.

In addition, the 501(c)(3) organization will not be subject to UBTI on income earned by renting or operating the property for a period of 10 years if the recipient does not "assume or agree to pay" the debt. It is permissible for the 501(c)(3) organization recipient to *actually pay* the debt, but the donor still may not take on the recourse nature of the debt. In order to allow transfer, the bank will require "non-recourse carve-outs," which if violated require the recipient to pay the debt.

4. Excess Business Holding Rules (IRC § 4943(c)(1))

IRC § 4943(c)(2) provides how much stock or other interests in a business enterprise a 501(c)(3) may hold. Anything in excess of the permitted holdings will be considered excess business holdings. These Excess Business Holding Rules generally limit a Private Foundation to holding no more than 20% of the voting stock of a business entity.

This rule only applies when the charitable organization has more than 20% of the voting rights in the entity. The charitable organization could hold 99% ownership without voting rights, and the excess business holding rules would not apply

There are prominent exceptions for entities that are strictly passive ("passive income exclusion") and entities that serve solely charitable purposes ("functionally related entity"), as described below.

[314] Treas. Reg. § 1.514(c)-1(c)(1) (as amended in 1980).

While the Excess Business Holding Rules are commonly seen as an obstacle that prohibit an organization and its related party owners from owning more than 20% of a business, the rules can be overcome by the following exceptions:

1. <u>5-Year Reduction Period</u>

A Private Foundation has until the 60th month after receipt of more than 20% of the voting stock in a business entity to divest itself of such stock, or to at least reduce its ownership to below the 20% level. This time period can be extended by 5 years if the organization can meet the following requirements provided under IRC § 4943(c)(7):

a. First, the foundation must establish that both:

1. Diligent efforts to dispose of such holdings were made during the initial 5-year period, and

2. Disposition within the initial 5-year period has not been possible (except at a price substantially below fair market value) by reason of the size, complexity, or diversity of such holdings.

b. The third and fourth requirements are that before the end of the initial 5-year period:

3. The Private Foundation submits a plan for disposing of all of the excess business holdings involved in the extension to the IRS as a Private Letter Ruling request[315] that is timely filed, and

4. The Private Foundation submits the plan described above to the Attorney General (or other appropriate State official) having authority or responsibility with respect to the matter and provides a copy of any response received from the Attorney General (or other appropriate State official) to the IRS during such 5-year period, and

c. The fifth requirement is as follows:

5. The IRS determines that such plan can be reasonably expected to be carried out before the close of the extension period (by the end of the tenth year after receipt). The extension request must be submitted as a Private Letter Ruling request to the Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes).[316]

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[315] *Reducing Private Foundation Excess Business Holdings: Additional Time to Dispose of Large Gifts or Bequests*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/reducing-private-foundation-excess-business-holdings-additional-time-to-dispose-of-large-gifts-or-bequests ("A request for extension of the period for disposition, as well as the copy of any response received from state officials, should be submitted as a private letter ruling request.").

[316] *IRC Section 4943(c)(7), Extension of Period to Dispose of Certain Assets*, I.R.S. (Sept. 27, 2021), https://www.irs.gov/charities-non-profits/irc-section-4943c7-extension-of-period-to-dispose-of-certain-assets.

2. Passive Income Exclusion

Entities having only passive income are excluded from the Excess Business Holding Rules. This would include most triple net lease situations.

This is because, for the purposes of the Excess Business Holding Rules, the term "business enterprise" does not include entities that receive at least 95% of their gross income from passive sources.[317] Therefore, a foundation may own up to 100% of an entity that derives at least 95% of its income from a passive source.

3. Functionally Related Entities

Entities that are functionally related to the tax-exempt purpose of the foundation are also excluded from the Excess Business Holding Rules. This is because, for the purposes of the Excess Business Holding Rules, the term "business enterprise" does not include entities that are functionally related (as defined in section 942(j)(4)).[318] Because of this, if an entity is classified as being a functionally related business, the foundation can hold 100% of that entity.

Please note that the Self-Dealing Rules and Unrelated Business Income Tax rules will still apply when a 501(c)(3) organization holds interests in business and investment entities.

Treasury Regulation § 53.4942(a)-2(c)(3)(iii)(b) provides the following examples of functionally related businesses:[319]

> Example (1) [Restaurant and hotel operated by a Private Foundation within a community of historic value]
>
> X, a private foundation, maintains a community of historic value which is open to the general public. For the convenience of the public, X, through a wholly owned, separately incorporated, taxable entity, maintains a restaurant and hotel in such community. Such facilities are within the larger aggregate of activities which makes available for public enjoyment the various buildings of historic interest and which is related to X's exempt purpose. Thus, the operation of the restaurant and hotel under such circumstances constitutes a functionally related business.
>
> Example (2) [Advertising space sold in a medical journal published by a Private Foundation]
>
> Y, a private foundation, as part of its medical research program under section 501(c)(3), publishes a medical journal in carrying out its exempt purpose. Space in the journal is sold for commercial

[317] I.R.C. § 4943(d)(3)(B).
[318] I.R.C. § 4943(d)(3)(B).
[319] Short summaries of each example are provided in brackets and are not part of the Treasury Regulation.

> advertising. Notwithstanding the fact that the advertising activity may be subject to the tax imposed by section 511, such activity is within a larger complex of endeavors which makes available to the scientific community and the general public developments with respect to medical research and is therefore a functionally related business.

4. <u>Jeopardizing Investments</u>

IRC § 4944 prohibits a Private Foundation from making investments that jeopardize the carrying out of any of its exempt purposes.[320]

Most advisors are well aware of high risk and non-fiduciary investments, and it makes perfect sense that the tax law prohibits or penalizes conduct that puts charitable entities and conduct at risk.

Treas. Reg. § 53.4944-1(a)(2)(i) provides the standards for determining "on an investment by investment basis" whether foundation managers have" failed to exercise ordinary business care and prudence . . . as of the time that the foundation makes the investment and not subsequently on the basis of hindsight." The Regulation permits foundation managers to consider the following factors when making investment decisions:

- the expected return (including both income and appreciation of capital),
- the risks of rising and falling price levels, and
- the need for diversification within the investment portfolio (for example, with respect to type of security, type of industry, maturity of company, degree of risk and potential for return).

The Regulation provides that "[n]o category of investments shall be treated as a per se violation of section 4944," but lists the following as examples of investments that will be "closely scrutinized":

- Trading in securities on margin,
- trading in commodity futures,
- investments in working interests in oil and gas wells,
- the purchase of "puts," "calls," and "straddles,"
- the purchase of warrants, and
- selling short.

Once a determination has been made "that an investment does not jeopardize the carrying out of a foundation's exempt purposes, the investment shall never be considered to

[320] I.R.C. § 4944(a)(1).

jeopardize the carrying out of such purposes, even though, as a result of such investment, the foundation subsequently realizes a loss." [321] However, state law and fiduciary standards may impose liability upon foundation managers and other individuals and entities if value is lost as the result of questionable investments.

5. Program Related Investments (An Exception to the Jeopardizing Investments Rules)

IRC § 4944(c) provides that "investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes."

Examples of this include property acquired to be used and enjoyed by the general public or to be preserved from development and to save plant and animal life.

Treasury Regulation § 53.4944-3(b) provides the following examples of program-related investments:[322]

> **Example (1) [Loan by a Private Foundation at below market interest rate to a small business in deteriorated urban area]**
>
> X is a small business enterprise located in a deteriorated urban area and owned by members of an economically disadvantaged minority group. Conventional sources of funds are unwilling or unable to provide funds to X on terms it considers economically feasible. Y, a private foundation, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk. Y's primary purpose for making the loan is to encourage the economic development of such minority groups. The loan has no significant purpose involving the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment even though Y may earn income from the investment in an amount comparable to or higher than earnings from conventional portfolio investments.
>
> **Example (5) [Loan by a Private Foundation to a publicly traded company at below market interest rate to establish a new plant in a deteriorated urban area]**
>
> X is a business enterprise which is financially secure and the stock of which is listed and traded on a national exchange. Y, a private foundation, makes a loan to X at an interest rate below the market

[321] Reformatted in-text lists into bulleted lists.

[322] Short summaries of each example are provided in brackets and are not part of the Treasury Regulation.

rate in order to induce X to establish a new plant in a deteriorated urban area which, because of the high risks involved, X would be unwilling to establish absent such inducement. The loan is made pursuant to a program run by Y to enhance the economic development of the area by, for example, providing employment opportunities for low-income persons at the new plant, and no significant purpose involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, even though X is large and established, the investment is program-related.

Example (9) [Interest-free loan by a Private Foundation to an economically disadvantaged individual to attend college]

X is a socially and economically disadvantaged individual. Y, a private foundation, makes an interest-free loan to X for the primary purpose of enabling X to attend college. The loan has no significant purpose involving the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment.

Example (10) [A high-risk investment in low-income housing by a Private Foundation]

Y, a private foundation, makes a high-risk investment in low-income housing, the indebtedness with respect to which is insured by the Federal Housing Administration. Y's primary purpose in making the investment is to finance the purchase, rehabilitation, and construction of housing for low-income persons. The investment has no significant purpose involving the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the investment is program-related.

Treas. Reg. § 53.4944-3(a) provides the following:

(a) In general.

(1) For purposes of section 4944 and §§ 53.4944-1 through 53.4944-6, a “program-related investment” shall not be classified as an investment which jeopardizes the carrying out of the exempt purposes of a Private Foundation. A

program-related investment is an investment which possesses the following characteristics:

(i) The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B);

(ii) No significant purpose of the investment is the production of income or the appreciation of property; and

(iii) No purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D).

(2)

(i) An investment shall be considered as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B) if it significantly furthers the accomplishment of the Private Foundation's exempt activities and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities. For purposes of section 4944 and §§ 53.4944-1 through 53.4944-6, the term *purposes described in section 170(c)(2)(B)* shall be treated as including purposes described in section 170(c)(2)(B) whether or not carried out by organizations described in section 170(c).

(ii) An investment in an activity described in section 4942(j)(4)(B) and the regulations thereunder shall be considered, for purposes of this paragraph, as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B).

(iii) In determining whether a significant purpose of an investment is the production of income or the appreciation of property, it shall be relevant whether investors solely engaged in the investment for profit would be likely to make the investment on the same terms as the Private Foundation. However, the fact that an investment produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant

> purpose involving the production of income or the appreciation of property.
>
> (iv) An investment shall not be considered as made to accomplish one or more of the purposes described in section 170(c)(2)(D) if the recipient of the investment appears before, or communicates to, any legislative body with respect to legislation or proposed legislation of direct interest to such recipient, provided that the expense of engaging in such activities would qualify as a deduction under section 162.

Program Related Investments are not only exempt from the Jeopardizing Investment Rules, but they can also have favorable attributes when held by Private Foundations:

1. The acquisition and maintenance costs of purchasing and maintaining Program Related Investments are treated as qualifying distributions for purposes of meeting a Private Foundation's 4.25% annual minimum distribution requirement under IRC § 4942.

2. The value of Program Related Investments is not included in the calculation of the 4.25% annual minimum distribution requirement under IRC § 4942.

3. Program Related Investments are not included in the calculation of Excess Business Holdings under IRC § 4943.

4. Program Related Investments are not treated as taxable expenditures under IRC § 4945 if the Private Foundation, when applicable, meets the expenditure responsibility requirements.

6. Navigating the Dangerous Waters of Unrelated Business Taxable Income

1. Why UBTI?

The primary purpose of the Unrelated Business Taxable Income ("UBTI") rules is to level the playing field between for-profit businesses and certain not-for-profit organizations that compete with them.

A second purpose of the rules is to have organizations pay their fair share of taxes when they are really active businesses "disguised" as a charity.

A third purpose is to measure the amount of UBTI that a charitable organization receives in order to determine whether it should be disqualified because it is "significantly non-charitable." This disqualification can occur even if a significant amount of UBTI is the result of ownership of interests in entities taxed as partnerships and S corporations. The 501(c)(3) organization will be considered to be engaging in the activities of a partnership that it owns an interest in.[323] However, there would not be a problem if the entities are taxed as separately managed and purposed C corporations.

The general rule is that an exempt organization must not serve a substantial non-exempt purpose. It is therefore necessary to review the size and scope of any unrelated or for-profit business or other non-charitable activity of the entity and entities that it may own, control, or be a significant owner of in order to determine whether such non-charitable activities are substantial compared to the exempt organization's other assets, revenues, and activities.

Common sources of UBTI for charities include direct ownership of an LLC or activities by the charity that do not meet one of the numerous exceptions for charitable-related businesses and events. These exceptions include the gift shop of a hospital, a thrift store operated for a bona fide charity, or not more frequently than annual fundraising activities (which is why they are almost always annual and not more frequent).

Under IRC § 512(e)(1), a charitable organization's ownership of an S corporation is treated as if it were an interest in an unrelated trade or business, so that all items of income, loss, and deduction reported on the K-1 must be taken into account in computing the charity's UBTI, notwithstanding that some or all of such income might be from charitable or other activities that would typically not be UBTI.

The gain or loss from the sale of stock of an S corporation is also UBTI, and thus taxable to the charity that receives monies in redemption or liquidation of it. Additionally, any income passed through to a non-profit parent entity from an S corporation, whether that subsidiary is a for-profit or non-profit business, will be considered UBTI. There are very few situations in which a non-profit entity owning an interest in a profitable S corporation would make any financial sense. The UBTI penalty that applies to S corporations does not apply to other entities.

The above arrangements may be best handled by having the charity convey the assets and/or activities into a limited liability company or a corporation that would be separately managed and treated as a C corporation for income tax purposes, pay taxes at the federal and state corporate rates, and then remit remaining funds as tax-free dividends to the charity. Dividends are *not* UBTI, so there would only be one layer of tax at the corporate level and no UBTI.

For this reason, many charitable organizations with large endowments do not invest in or accept interests in entities taxed as partnerships or S corporations and may transfer such interests into entities taxed as C corporations to act as "UBTI blockers," as discussed below.

2. Use of C Corporations to Block UBTI from direct ownership of too much non-charitable business income received.

A 501(c)(3) organization can lose its tax-exempt status because it has too much UBTI from direct ownership of or income received from an S corporation or partnership. It is therefore

[323] *See Redlands Surgical Serve v. Comm'r,* 113 T.C. 47 (1999), *aff'd* 242 F.3d 904 (9th Cir. 2001).

common for charitable organizations to transfer such interests to a C corporation that is owned by the nonprofit entity. The C corporation will be taxed on its income, and the nonprofit entity will normally not be taxed on the dividends it receives from the C corporation.

For example, a taxpayer may own an interest in an LLC taxed as a partnership that operates a business and may wish to donate a percentage ownership in the LLC to charity. The charity may not be willing to accept the partnership interest because it will subject the charity to UBTI, which could exceed the distributions that the charity receives from the partnership and might cause disqualification of the 501(c)(3) status of the organization if the UBTI is significant.

Some advisors encourage clients to have non-business assets held directly by a 501(c)(3) organization so that the dividends, interest, and capital gains from them will not be taxable. Those assets may nevertheless be pledged as collateral to allow a C corporation also owned by the 501(c)(3) organization to secure financing, and the C corporation will not be subject to unrelated business taxable income.

As further discussed in Section H, while rental income from real estate is normally not subject to UBTI, it may be if the real estate is subject to debt, the real estate related activity is more than just a rental or is a percentage of profits rental, or there are significant non-rental real estate aspects, such as the rental of significant amount of personal property or business activities of a for-profit subsidiary that is disregarded or taxed as a partnership or S corporation.

There is a lot of confusion surrounding the use of a C corporation entity to block UBTI from passing through to a non-profit entity. A number of articles have incorrectly indicated that a C corporation "blocker" entity will not work to prevent the UBTI income from passing through directly to the non-profit. This confusion comes from the difficult-to-understand language of IRC § 512(b)(13), which is designed to prevent a for-profit subsidiary from avoiding the UBTI tax by paying interest, rent, or royalties to a non-profit parent company. The types of payment that are taxed by IRC §512(b)(13) exclude dividends. As long as the C corporation "blocker" entity is paying its regular corporate income taxes on the income it receives, then the dividend payments that it transmits to the parent non-profit entity will not be taxable to the non-profit parent organization.

Unfortunately, a 501(c)(3) organization's ownership interest in an S corporation cannot be transferred to a C corporation "blocker" without causing loss of the S election. The authors have been unable to find literature discussing whether an irrevocable trust funded by a 501(c)(3) company could make an Electing Small Business Trust ("ESBT") election, but it would appear that a trust formed by a 501(c)(3) organization that would benefit that organization would have to be disregarded for income tax purposes pursuant to IRC § 671. It is conceivable that a Section 501(c)(3) organization could establish an irrevocable trust for the benefit of another 501(c)(3) organization that could be considered a complex trust for income tax purposes, but the authors have found no reference materials that verify this, so it would seem risky to attempt to do so.

While the transfer of a partnership interest to a C corporation wholly owned by the contributing partner may be tax free under IRC § 351, income tax will trigger to the extent that the partner's pro rata share of the liabilities of the partnership exceed the partner's basis in the partnership ("outside basis") under IRC § 357. For tax purposes, when an interest in a partnership is transferred to a C corporation, the C Corporation is deemed to have assumed the applicable share of liabilities associated with the partnership interest. Therefore, advisors should confirm whether the partner's basis in the partnership exceeds their applicable share of liabilities of the partnership prior to contributing the interest to a C corporation.

For example, if ABC partnership has total liabilities of $3,000,000, and A's basis in ABC is $2,000,000 and 10% of A's ownership of ABC is transferred to a C corporation, the C corporation will be deemed to have assumed liabilities of $300,000. A's basis in the 10% transferred would be equal to $200,000, and therefore $100,000 of income would be recognized by A on the transfer.

In order to avoid imposition of UBTI-related taxes, the Private Operating Foundation can own a C corporation that can in turn own the partnership interest. The C corporation will be taxed at approximately 25% on the income passed through the partnership. This includes the 21% federal income tax rate and the 5.5% Florida tax rate. The Florida tax is deductible on the Federal return, so the effective rate is approximately 25%. Dividends from the C corporation will flow tax free to the charity.

The tax cost of transferring a partnership interest to a C corporation must be considered. If the charity is willing to accept the partnership interest in a way that would not impact its status as a charity, with the understanding that income received from the partnership will be subject to UBTI, the UBTI 501(c)(3) corporation will be subject to tax at the rate that otherwise applies to Corporations (currently 21%). If the 501(c)(3) organization is a trust then it will be taxed at the higher trust rates, which reach 37% on income exceeding $13,451 for 2022. In other words, the same taxes would apply if the partnership interest was held directly by charity (21% on UBTI) or if the partnership interest was held by a C corporation owned by the charity (21% corporate tax rate).

3. <u>Convert Partnership Interests to C Corporations or Have Them Held by C Corporations</u>

Many taxpayers convert partnerships into Tenants in Common arrangements with the former or would-be partners becoming co-tenants so that there is no transfer that triggers partnership tax K-1 income to the donor.

For example, Harry and Sally are not married and own a building on 22nd St. in NYC and a company called Organic Deli, which operates a restaurant in the building. They eat there often.

Harry would like to donate his one-half of the building to charity.

The LLC, which owns the building and is in turn owned 50% by Harry and 50% by Sally, transfers one-half of its real estate interest to an LLC owned by Harry and the other one-half to an LLC owned by Sally. They sign a bona fide Tenants in Common Agreement so that neither one of them are partners in a partnership.

Now Harry can donate the ownership of his LLC to charity and the charity will not have to be concerned with possible UBTI by reason of receiving an interest in a partnership. The charity will receive net rent income, which is not subject to the Unrelated Business Income Tax so long as the property is not leveraged. "Debt financed" income will still be subject to UBTI, although some exceptions can apply.

4. Using A Foreign Corporation Blocker

If a partnership owned in part by a 501(c)(3) organization acquires investment property using borrowed funds, then the 501(c)(3) organization's distributive share of partnership income is treated as UBTI pro rata to the debt. If a C corporation owns the partnership interest and a 501(c)(3) owns the C corporation, then there is no UBTI imposed, and the C corporation will pay normal tax on its K-1 income.

The IRS issued the below referenced string of rulings in 2003 regarding four Charitable Remainder Trusts that formed and placed United States partnership interests into a foreign corporation that was treated as a C corporation for income tax purposes.[324] The IRS ruled that the income of the partnership would not constitute UBTI if (1) appropriate corporate formalities were followed, (2) the foreign corporation and its partnership interests were separate from the trusts and their assets, and (3) the company was not acting as an agent for any of the trusts or their trustees.

P.L.R. 200315028 (Apr. 11, 2003), P.L.R. 200315032 (Apr. 11, 2003), P.L.R. 200315034 (Apr. 11, 2003), and P.L.R. 200315035 (Apr. 11, 2003) all include the following language to explain the business reasons for why foreign blockers were used:

> The trustees of the CRTs represent that they have a number of business purposes for establishing the foreign corporation and pooling the assets of the CRTs. Such reasons include the fact the foreign corporation may manage and administer the CRTs' investments as a group. This will help minimize the administrative and advisor costs of investing, help diversify assets, and gain access to additional investment opportunities. Further, the use of the foreign corporation will provide an additional layer of limited liability protection for the CRTs against liabilities in the evolving area of lender liability and against other liabilities. The foreign corporation provides greater flexibility for investment in that stock of the corporation may be more readily transferred than other investment forms.

A 2015 article by Norman I. Silber and John C. Wei entitled "The Use of Offshore Blocker Corporations by U.S. Nonprofits: Should Blockers Be Blocked?"[325] provides the following reasons for why many U.S. non-profits use offshore blocker corporations, besides the ability to defer taxation on corporate income until it is repatriated:

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[324] I.R.S. Priv. Ltr. Rul. 200315028 (Apr. 11, 2003), I.R.S. Priv. Ltr. Rul. 200315032 (Apr. 11, 2003), I.R.S. Priv. Ltr. Rul. 200315034 (Apr. 11, 2003), and I.R.S. Priv. Ltr. Rul. 200315035 (Apr. 11, 2003).

[325] Norman I. Silber & John C. Wei, *The Use of Offshore Blocker Corporations by U.S. Nonprofits: Should Blockers Be Blocked?*, 6 Nonprofit Policy Forum 353 (2015).

• "[T]o avoid incurring . . . the debt-financed unrelated business income tax (UBIT), and the additional income tax reporting obligations that go along with it."

• "A nonprofit's mission . . . may be to provide services outside the United States, and to accomplish this mission, a nonprofit may have no choice but to use subordinated or affiliated foreign legal entities."

• "An internationally oriented nonprofit . . . might create a foreign corporate subsidiary to segregate liability."

• "A number of countries grant charitable deductions only to contributions that are made to domestically organized charities or to select foreign charities."

• "[F]or local business purposes, for instance, so that it can open a local bank account."

5. <u>Will the Existence of a For-Profit Subsidiary Cause Loss of Tax-Exempt Status?</u>

It is important to determine whether having a foreign or domestic business subsidiary owned by a 501(c)(3) organization may cause loss of tax-exempt status. The primary criteria are whether there is a business purpose for forming the subsidiary and the degree of control that the 501(c)(3) parent entity will have over the subsidiary's functioning.

The income and activities of a for-profit C corporation that is owned by an exempt organization may be attributed to such exempt organization and thus be subject to UBTI or may disqualify the 501(c)(3), unless there is (1) a business purpose for forming the subsidiary, and (2) a degree of independence so that the parent exempt organization does not control the for-profit subsidiary.[326]

PLR 201503018 (January 20, 2015) has been referred to as a "classic case of a proper relationship between an exempt organization and a for-profit subsidiary."[327]

This ruling was requested by a 501(c)(3) educational institution that was originally formed as an accounting and secretarial school. The institution later evolved into a multi-disciplinary institution offering associates, bachelors, masters, and doctoral degrees for students of their graduate and undergraduate programs. To improve educational opportunities for working adults, the institution launched an online competency-based learning program that allowed students to enroll in self-paced and self-directed educational courses.

At the time of implementing this program, there were no other universities offering degree programs based on this structure, so the institution developed their own software to run and track

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[326] *See Better Bus. Bureau v. United States,* 326 U.S. 279 (1945) (exemption denied where the subsidiary had a non-exempt purpose); I.R.S. Priv. Ltr. Rul. 201644019 (August 2, 2016) (for-profit subsidiary's activities deemed to be separate from the exempt parent organization because the subsidiary was involved with strategic planning for a partnership that it held an interest in).

[327] Carla Neeley Freitag, 462-2nd T.M., *Tax-Exempt Organizations — Unrelated Business Income Tax (Sections 511, 512, and 513), II., D. Nonexempt Organizations*.

the program. Subsequently, other educational institutions inquired about licensing the software from the educational institution.

When the ruling was requested, the institution was in the process of determining whether the licensing of the software to other entities could be a viable commercial business. The institution eventually formed a for-profit subsidiary to further develop the software and license it to other educational institutions and commercial businesses.

The subsidiary did not have any employees or any activities. The institution was proposing to contribute the software to the subsidiary while retaining a royalty-free license for use in their own operations. Further, the subsidiary would determine and charge a fair market price for the license of the software to unaffiliated organizations to use to create their own educational programs.

The proposed ownership, structure, operation, and relationship between the educational institutional and the subsidiary were as follows:

- The institution would own 100% of the stock in the subsidiary and would appoint all of its directors.

- The initial board of directors of the subsidiary would consist of three members of the institution's board of directors, but the institution planned to expand the board of directors of the subsidiary to include seven persons within six months of formation and prior to the commencement of any substantial activities.

- Pursuant to the subsidiary's bylaws, a majority of the directors would not be employed by the institution, be on the institution's board of directors, or be related to a person employed by or on the institution's board. Additionally, the president of the subsidiary would not be either a person who is on the institution's board nor one of their employees.

- All compensation that the subsidiary paid to its directors, officers, employees, and agents for services rendered would be reasonable.

- Any equity-based compensation system for the subsidiary's directors and employees would conform to those offered by comparable entities.

- The institution would not actively participate in the day-to-day operations of the subsidiary.

- The subsidiary would also maintain separate facilities, addresses, telephone numbers, telephone listings, and bank accounts and other financial records. However, in the event that the subsidiary was to lease office space or receive administrative services from the institution, then the subsidiary, as required by its bylaws, would reimburse the institution for the fair market value of such use.

- The dividends that the institution expected to receive from the subsidiary would be an insignificant percentage of its total support.

Based on the above, the IRS ruled as follows:

- The institution's ownership of the subsidiary would not have an adverse effect on the institution's tax-exempt status under IRC § 501(c)(3) because the subsidiary would be treated as a separate entity for tax purposes and the income and activities of the subsidiary should not be attributable to the institution as the parent corporation.

- The income of the subsidiary would not be treated as UBTI to the institution under IRC § 512(a)(1) because the subsidiary's activities and operations would be conducted solely by the subsidiary, would not be attributed to the institution, and would therefore not be considered to be a trade or business that is "regularly carried on" by the institution.

- Any dividends the institution would receive from the subsidiary would be excluded under IRC § 512(b)(1) from the computation of UBTI under IRC § 512(a)(1).

6. Can a Charity Sell Property Without Being a Dealer? No Deal.

PLR 200119061 (February 14, 2001) analyzed a 501(c)(3) charity that purchased parcels of real estate in sparsely populated areas and then sold the parcels when the surrounding area had become more heavily populated. Over a period of 15 years, the charity sold land mostly to developers for profit.

The IRS ruled that the charity, despite "engag[ing] in [a] regularly carried on trade or business," was also substantially and regularly carrying out an unrelated trade or business. The IRS looked at the following items when determining how to divide the unrelated business activities from those activities related to the exempt purpose of the charity:

- Why the assets were acquired,
- The "frequency, continuity and size of sales,"
- The extent of improvements made to the property,
- The commercial loan devices used by the 501(c)(3) charity,
- The proximity of the time of purchase and the time of sale, and
- The purpose for which the property was held.

7. Exclusions from UBTI

1. Passive Income

Generally, unrelated income that is passive is not subject to UBTI.[328] Passive income is defined as income that the business is not actively involved in generating and normally includes rents from real property, interest, dividends received from C corporations, and royalties.[329] There are exceptions to these general rules, so each source of income should be evaluated in relation to the UBTI rules.

The borrowers commonly forget or do not know that passive income passing through an S corporation by K-1 reporting is taxable to a 501(c)(3) organization as if it were active, as are profits from sale or redemption of the entity that got them the S corporation interest.

2. Interest and Dividends

IRC § 512(b)(1) provides that “[t]here shall be excluded all dividends, interest, payments with respect to securities loans (as defined in subsection (a)(5)), amounts received or accrued as consideration for entering into agreements to make loans, and annuities, and all deductions directly connected with such income.”

3. Rent Derived Primarily from Real Estate

Treas. Reg. § 1.512(b)-1(c) is provided, in relevant portion, below:

> (c) Rents—
>
> > (1) Taxable years beginning before January 1, 1970. For taxable years beginning before January 1, 1970, rents from real property (including personal property leased with the real property) and the deductions directly connected therewith shall be excluded in computing unrelated business taxable income, except that certain rents from, and certain deductions in connection with, a business lease (as defined in section 514(f)) shall be included in computing unrelated business taxable income. See subparagraph (5) of this paragraph for rules governing amounts received for the rendering of services.
> >
> > (2) Taxable years beginning after December 31, 1969—
> >
> > > (i) In general. For taxable years beginning after December 31, 1969, except as provided in subdivision (iii) of this subparagraph, rents from property described in subdivision (ii) of this

[328]I.R.C. § 512(b)(1) and Treas. Reg. §§ 1.512(b)-1(a)-(d) exclude interest income, dividends, rents from real property (where personal property does not make up a significant portion of the rental amount) and royalty payments. There are exceptions to this exception so care must be taken with any form of passive income.
[329] I.R.C. § 512(b)(3).

> subparagraph, and the deductions directly connected therewith, shall be excluded in computing unrelated business taxable income. However, notwithstanding subdivision (ii) of this subparagraph, certain rents from and certain deductions in connection with either debt-financed property (as defined in section 514(b)) or property rented to controlled organizations (as defined in paragraph (l) of this section) shall be included in computing unrelated business taxable income.
>
> (ii) Excluded rents. The rents which are excluded from unrelated business income under section 512(b)(3)(A) and this paragraph are:
>
> (a) Real property. All rents from real property; and
>
> (b) Personal property. All rents from personal property leased with real property if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time personal property are an incidental amount service by the lessee.

All rents from real property (including property described in IRC § 1245(a)(3)(C)) are excluded from UBTI under IRC § 512(b)(3)(A)(i) unless an exception below applies.

Also excluded from UBTI under IRC § 512(b)(3)(A)(ii) are:

> [A]ll rents from personal property (including for purposes of this paragraph as personal property any property described in section 1245(a)(3)(B)) leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Treas. Reg. § 1.512(b)-1(c)(2)(ii)(b) provides that "rents attributable to personal property generally are not an incidental amount of the total rents if such rents exceed 10[%] of the total rents from all the property leased." If the rents attributable to personal property do exceed 10% but do not exceed 50%, only such rents attributable to real property are excluded from UBTI while those attributable to personal property are not excluded from UBTI.

Example: Is income from a billboard "rent from real property" for purposes of the UBTI rent exception?

Maybe—it will be under proper circumstances if the IRS follows its rulings in non-UBTI-related Private Letter Rulings where it considered billboard rental income to be "rents from real property."

For non-UBTI purposes (that of a real estate investment trust) the IRS has considered rental income from billboards attached to both a building and a concrete slab (PLR 201143011) and rental income from Outdoor Advertising Displays (PLR 201431020) to be "rents from real property."

The primary exceptions to this rental exclusion are as follows:

- The rental exclusion does not apply "if more than 50[%] of the total rent received or accrued under the lease is attributable to personal property," determined at the time the personal property is first placed into service.[330]

- The rental exclusion does not apply "if the . . . amount of [the] rent depends . . . on the income or profits derived by any person from the [leased] property (other than an amount based on a fixed percentage . . . of [the gross] receipts or sales."[331]

- "[P]ayments for the use or occupancy of rooms and other space where services are also rendered to the occupant" are not exempt when "services are also rendered [that do] not constitute rent from real property."[332] This normally applies if "the services are (1) primarily for the convenience of the occupant and (2) are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only."[333]

- The exclusion does not apply to rent attributable to certain debt-financed property.

- This exclusion does not apply to rent derived from a controlled entity in IRC § 512(b)(13).

4. Gains and Losses from the Sale of Property (Other than inventory for sale)

[330] I.R.C. § 512(b)(3)(B)(i) and Treas. Reg. § 1.512(b)-1(c)(2)(iii)(a) (as amended in 2020).
[331] I.R.C. § 512(b)(3)(B)(ii).
[332] Treas. Reg. § 1.512(b)-1(c)(5) (as amended in 2020).
[333] *Id.*

Gains or losses from the sale or disposition of property are not subject to the Unrelated Business Income Tax, except for the sale of "inventory," meaning any property held primarily for sale to customers that results in ordinary income when sold.[334]

IRC §§ 512(b)(5)(A) and (B) provide as follows:

> (5) There shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than—
>
> (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or
> (B) property held primarily for sale to customers in the ordinary course of the trade or business.

An exception to this is timber. IRC § 512(b)(5) does not apply to the sale of timber that is cut in accordance with IRC § 631 (dealing with gain or loss from timber, coal, or iron ore).

5. Royalties

IRC § 512(b)(2) provides that "[t]here shall be excluded all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income."

Revenue Ruling 81-178 defines "royalty" for purposes of § 512 as "a payment . . . relate[d] to the use of a valuable [property] right" and provides the following examples:

> Payments for the use of trademarks, trade names, service marks, or copyrights, whether or not based upon the use made of such property, are ordinarily classified as royalties for federal tax purposes. Similarly, payments for the use of a professional athlete's name, photograph, likeness, or facsimile signature are ordinarily characterized as royalties. On the other hand, royalties do not include payments for personal services.[335]

A mineral royalty is the right to a specified percentage of revenue from a property's production of oil, gas, or other mineral interests. This can be exempt from UBTI, even if based upon the gross or taxable income from the mineral operation, as long as the 501(c)(3) organization does not own a working interest in the property and would share in development costs.

Treas. Reg. § 1.512(b)-1(b) provides the following with respect to mineral royalties:

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[334] I.R.C. §§ 512(b)(5)(A) and (B).
[335] Rev. Rul. 81-178, 1981-2 C.B. 135 (citations omitted).

> Mineral royalties shall be excluded whether measured by production or by gross or taxable income from the mineral property. However, where an organization owns a working interest in a mineral property, and is not relieved of its share of the development costs by the terms of any agreement with an operator, income received from such an interest shall not be excluded. To the extent not treated as a loan under section 636, payments in discharge of mineral production payments shall be treated in the same manner as royalty payments for the purpose of computing unrelated business taxable income. To the extent treated as a loan under section 636, the amount of any payment in discharge of a production payment which is the equivalent of interest shall be treated as interest for purposes of section 512(b)(1) and paragraph (a) of this section.

<u>Mineral Royalty Example</u>: Proper Lease Terms for the Sale of Sand and Gravel Removed from Property

In PLR 9231045 (July 31, 1992), a cemetery company exempt from taxation under IRC § 501(c)(13) proposed to lease a section of its property to a for-profit corporation that would develop and operate golf courses on the land. The lease provided that the cemetery company would receive fair value rent for use of the land and a royalty for any sand and gravel that the for-profit corporation removed and sold from the leased property in the course of landscaping and contouring the property for use as a golf course. Further, the lease provided that all sand or gravel removal would be at the expense of the for-profit corporation and the royalty to be paid to the cemetery company would be determined by an independent appraiser.

Based on these facts, the IRS ruled that the rent income from the lease would be excluded from UBTI income because it would be "based on a fixed percentage of receipts or sales, as provided in section 512(b)(3)(B)(ii)." The income from the removal and sale of any sand or gravel from the leased premises would be a royalty falling within the modifications provided in IRC § 512(b)(2) and would be excluded from UBTI. Accordingly, the IRS ruled that any royalties received with respect to the disposition of sand or gravel would not result in UBTI for the non-profit cemetery under IRC § 512.

6. <u>Income from Certain Non-Charitable Research Activities</u>

IRC § 512(b)(7) provides that "[t]here shall be excluded all income derived from research for: (A) the United States, or any of its agencies or instrumentalities, or (B) any State or political subdivision thereof; and there shall be excluded all deductions directly connected with such income."

Additionally, IRC § 512(b)(8) provides that "[i]n the case of a college, university, or hospital, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income."

Further, IRC § 512(b)(9) provides that "[i]n the case of an organization operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income."

7. Sufficiently Related Trade or Business Activities – When Related to Charitable Activities

IRC § 513 allows 501(c)(3) organizations to have profitable businesses that can operate without being taxed when they are sufficiently related to the trade or business of an exempt organization and thus not subjecting the income from those activities to UBTI. For example, a hospital's gift shop and cafeteria are sufficiently related, but a department store located next to the hospital or on the hospital campus would not be considered to be substantially related to the purpose of the hospital and therefore would not be excluded.

A non-exhaustive list of some of the activities excluded from UBTI under IRC § 513 is provided below.

1. Volunteer Activities

IRC § 513(a)(1) provides that business activities of a tax-exempt organization will be deemed to be related where "substantially all the work in carrying on such trade or business is performed for the organization without compensation."

2. Activities for the Convenience of Members, Students, Officers, Employees, etc.

A trade or business conducted by a 501(c)(3) organization or by a state college or university "primarily for the convenience of its members, students, patients, officers, or employees" is not subject to UBTI. [336]

"[I]n the case of a local association of employees described in [IRC §] 501(c)(4) organized before May 27, 1969," any trade or business that "is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment," is also not subject to UBTI.[337]

IRS Publication 598 indicates that the profits from "a laundry operated by a college for the purpose of laundering dormitory linens and students' clothing" will not be considered to be UBTI under this exclusion.[338]

[336] I.R.C. § 513(a)(2).
[337] I.R.C. § 513(a)(2).
[338] https://www.irs.gov/pub/irs-pdf/p598.pdf

3. Sales of Contributed Property

Commonly referred to as the "Thrift Shop Exception," IRC § 513(a)(3) provides that "the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions" is not an unrelated trade or business.

4. Bingo

Bingo is an interesting example of a "business" that may not be subject to the UBTI rules by reason of one or both of the following exceptions:

- Social Clubs. Bingo games conducted for a social club that is organized under IRC § 501(c)(7) is considered to be a related recreational activity. Money raised from the game itself will not be taxable to the social club.

- Volunteer Labor. For all other 501(c) entities, operating Bingo games will result in UBTI, unless it qualifies for the exception for volunteer labor under IRC § 513(a)(1), the Bingo game exception under Section 513(f), or the exception under Section 513(d) that provides that a "qualified public entertainment activity" that is conducted by a "qualifying organization" described in § 501(c)(3), (4), or (5) and is conducted in conjunction with public fairs or expositions is not an unrelated trade or business.

5. Hospital Services

The providing of certain services at or below cost by an exempt hospital to other exempt hospitals that have facilities for 100 or fewer inpatients is not an unrelated trade or business. This exclusion applies only to services described in IRC §501(e)(1)(A).

6. Phone and Electrical Pole Rentals Received by 501(c) Mutual or Cooperative Telephone or Electric Organizations

The term "unrelated trade or business" does not include a mutual or cooperative telephone or electric company engaging in qualified pole rentals, which are defined in IRC § 501(c)(12)(D):

> [T]he term "qualified pole rental" means any rental of a pole (or other structure used to support wires) if such pole (or other structure)—
>
> > (i) is used by the telephone or electric company to support one or more wires which are used by such company in providing telephone or electric services to its members, and

(ii) is used pursuant to the rental to support one or more wires (in addition to the wires described in clause (i)) for use in connection with the transmission by wire of electricity or of telephone or other communications.

For purposes of the preceding sentence, the term "rental" includes any sale of the right to use the pole (or other structure).

GLOSSARY

Term	Definition
35/65 Trust	IRC § 4946(a)(1)(G) provides that certain trusts and estates that have 35% or less of their beneficial interest held by Disqualified Person(s) will not be classified as disqualified by reason of such beneficial interest[s]. Therefore, a family wishing to control an entity partly owned by a charity of which they are Disqualified Persons can place all of the voting interests in the investment or business entity under a trust under which up to 35% of its beneficial interest is held for Disqualified Persons, and 65% of which is held for individuals or entities that are not Disqualified Persons.
501(c)(3) Charitable Organization	"To be tax-exempt under section 501(c)(3) of the Internal Revenue Code, an organization must be organized and operated exclusively for exempt purposes set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual. In addition, it may not be an action organization, i.e., it may not attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates. Organizations described in section 501(c)(3) are commonly referred to as charitable organizations. Organizations described in section 501(c)(3), other than testing for public safety organizations, are eligible to receive tax-deductible contributions in accordance with Code section 170. The organization must not be organized or operated for the benefit of private interests, and no part of a section 501(c)(3) organization's net earnings may inure to the benefit of any private shareholder or individual. If the organization engages in an excess benefit transaction with a person having substantial influence over the organization, an excise tax may be imposed on the person and any organization managers agreeing to the transaction. Section 501(c)(3) organizations are restricted in how much political and legislative (lobbying) activities they may conduct."[339]
501(c)(4) Organizations	"Internal Revenue Code section 501(c)(4) provides for the exemption of two very different types of organizations with their own distinct qualification requirements. They are: • Social welfare organizations: Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, and • Local associations of employees, the membership of which is limited to the employees of a designated person(s) in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational or recreational purposes. Homeowners associations and volunteer fire companies may be recognized as exempt as social welfare organizations if they meet the requirements for exemption. Organizations that engage in substantial lobbying activities sometimes also are classified as social welfare organizations."[340]

[339] *Exemption Requirements - 501(c)(3) Organizations*, I.R.S. (Feb. 17, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/exemption-requirements-501c3-organizations.
[340] *Types of Organizations Exempt under Section 501(c)(4)*, I.R.S. (Aug. 2, 2022), https://www.irs.gov/charities-non-profits/other-non-profits/types-of-organizations-exempt-under-section-501c4.

Term	Definition
Adjusted Gross Income (AGI)	"Adjusted Gross Income (AGI) is defined as gross income minus adjustments to income. Gross income includes your wages, dividends, capital gains, business income, retirement distributions as well as other income. Adjustments to Income include such items as Educator expenses, Student loan interest, Alimony payments or contributions to a retirement account. Your AGI will never be more than your Gross Total Income on you return and in some cases may be lower."[341]
Annuity	"An annuity is a contract that requires regular payments for more than one full year to the person entitled to receive the payments (annuitant). You can buy an annuity contract alone or with the help of your employer. Common Types of Annuities • Fixed period annuities - pay a fixed amount to an annuitant at regular intervals for a definite length of time. • Variable annuities - make payments to an annuitant varying in amount for a definite length of time or for life. The amounts paid may depend on variables such as profits earned by the pension or annuity funds or by cost-of-living indexes. • Single life annuities - pay a fixed amount at regular intervals during an annuitant's life, ending on his or her death. • Joint and survivor annuities - pay a fixed amount to the first annuitant at regular intervals for his or her life. After he or she dies, a second annuitant receives a fixed amount at regular intervals. This amount, paid for the life of the second annuitant, may be the same or different from the amount paid to the first annuitant. • Qualified employee annuities - a retirement annuity purchased by an employer for an employee under a plan that meets certain Internal Revenue Code requirements. • Tax-sheltered annuities - a special annuity plan or contract purchased for an employee of a public school or tax-exempt organization."[342]
Annuity Trust	"An annuity trust is a trust in which the payments for the duration of the trust, either to a private or charitable beneficiary, are of a fixed amount. The trustee(s) determine the payment amount by multiplying a specified percentage by the fair market value of the assets initially placed in the trust."[343]

[341] *Definition of Adjusted Gross Income*, I.R.S. (Jan. 7, 2022), https://www.irs.gov/e-file-providers/definition-of-adjusted-gross-income.
[342] *Annuities - A Brief Description*, I.R.S. (June 15, 2022), https://www.irs.gov/retirement-plans/annuities-a-brief-description.
[343] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 1, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.

Term	Definition
Arm's Length Transaction	"In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. Generally, agreements are made by two uncontrolled parties freely and independently of each other. If a controlled relationship between the parties exists (i.e.; related party transaction), the result can be a transfer price that is not arm's length. These are called controlled transactions. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result.) However, because identical transactions can rarely be located, whether a transaction produces an arm's length result generally will be determined by reference to the results of comparable transactions under comparable circumstances. Evaluation of whether a controlled transaction produces an arm's length result relies on and requires application of the best method analysis and other principles of section 482 and the regulations. The arm's length analysis begins with the factual and functional analysis of the actual transaction (or transactions) among the controlled parties."[344]
Bargain Sale	"If you sell or exchange property for less than fair market value with the intent of making a gift, the transaction is partly a sale or exchange and partly a gift. You have a gain if the amount realized is more than your adjusted basis in the property. However, you do not have a loss if the amount realized is less than the adjusted basis of the property. . . . A bargain sale of property to a charitable organization is partly a sale or exchange and partly a charitable contribution. If a charitable deduction for the contribution is allowable, you must allocate your adjusted basis in the property between the part sold and the part contributed based on the fair market value of each. . . . Based on this allocation rule, you will have a gain even if the amount realized is not more than your adjusted basis in the property. This allocation rule does not apply if a charitable contribution deduction is not allowable."[345]

[344] *LB&I International Practice Service Transaction Unit: Arm's Length Standard*, I.R.S., 3 (Sept. 3, 2014), https://www.irs.gov/pub/int_practice_units/ISI9422_09_06.PDF.
[345] *Publication 544 (2021), Sales and Other Dispositions of Assets*, I.R.S. (Feb. 17, 2022), https://www.irs.gov/publications/p544.

Term	Definition
Basis	"Basis is generally the amount of your capital investment in property for tax purposes. . . . In most situations, the basis of an asset is its cost to you. The cost is the amount you pay for it in cash, debt obligations, and other property or services. Cost includes sales tax and other expenses connected with the purchase. Your basis in some assets isn't determined by the cost to you. If you acquire property other than through a purchase (such as a gift or an inheritance), [different rules apply]. If you acquired your property from an individual who died in 2010, special rules may apply to your calculation of basis. . . . If you buy stocks or bonds, your basis is the purchase price plus any additional costs such as commissions and recording or transfer fees. If you have stocks or bonds that you didn't purchase, you may have to determine your basis by the fair market value of the stocks and bonds on the date of transfer or the basis of the previous owner. . . . Before figuring gain or loss on a sale, exchange, or other disposition of property, or before figuring allowable depreciation, you must determine your adjusted basis in that property. Certain events that occur during the period of your ownership may increase or decrease your basis, resulting in an 'adjusted basis.' Increase your basis by items such as the cost of improvements that add to the value of the property, and decrease it by items such as allowable depreciation and insurance reimbursements for casualty and theft losses."[346]
Beneficiary	"Beneficiary(ies) refers to the person, persons, or organization that receives payments or assets from a trust. Beneficiaries can be either charitable or non-charitable, and can be either an income beneficiary or a remainder beneficiary. The beneficiary holds the beneficial title to the trust property. The trust document must clearly identify the beneficiary or beneficiaries."[347]
C Corporation	"In forming a corporation, prospective shareholders exchange money, property, or both, for the corporation's capital stock. A corporation generally takes the same deductions as a sole proprietorship to figure its taxable income. A corporation can also take special deductions. For federal income tax purposes, a C corporation is recognized as a separate taxpaying entity. A corporation conducts business, realizes net income or loss, pays taxes and distributes profits to shareholders. The profit of a corporation is taxed to the corporation when earned, and then is taxed to the shareholders when distributed as dividends. This creates a double tax. The corporation does not get a tax deduction when it distributes dividends to shareholders. Shareholders cannot deduct any loss of the corporation."[348]

[346] *Topic No. 703 Basis of Assets*, I.R.S. (Aug. 29, 2022), https://www.irs.gov/taxtopics/tc703.
[347] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 1, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[348] *Forming a Corporation*, I.R.S. (June 23, 2022), https://www.irs.gov/businesses/small-businesses-self-employed/forming-a-corporation.

Term	Definition
Capital gain asset	"Almost everything you own and use for personal or investment purposes is a capital asset. Examples include a home, personal-use items like household furnishings, and stocks or bonds held as investments. When you sell a capital asset, the difference between the adjusted basis in the asset and the amount you realized from the sale is a capital gain or a capital loss. Generally, an asset's basis is its cost to the owner, but [different rules apply] if you received the asset as a gift or inheritance . . . You have a capital gain if you sell the asset for more than your adjusted basis. You have a capital loss if you sell the asset for less than your adjusted basis. Losses from the sale of personal-use property, such as your home or car, aren't tax deductible."[349]
Charitable Gift Annuity	"[T]he term 'charitable gift annuity' means an annuity if— (A) a portion of the amount paid in connection with the issuance of the annuity is allowable as a deduction under section 170 or 2055, and (B) the annuity is described in section 514(c)(5) (determined as if any amount paid in cash in connection with such issuance were property)."[350]
Charitable income tax deduction	"Contributions must actually be paid in cash or other property before the close of your tax year to be deductible, whether you use the cash or accrual method. . . . If you donate property other than cash to a qualified organization, you may generally deduct the fair market value of the property. If the property has appreciated in value, however, some adjustments may have to be made. . . . In general, contributions to charitable organizations may be deducted up to 50 percent of adjusted gross income computed without regard to net operating loss carrybacks. Contributions to certain private foundations, veterans organizations, fraternal societies, and cemetery organizations are limited to 30 percent adjusted gross income (computed without regard to net operating loss carrybacks), however. . . . The 50 percent limitation applies to (1) all public charities (code PC), (2) all private operating foundations (code POF), (3) certain private foundations that distribute the contributions they receive to public charities and private operating foundations within 2-1/2 months following the year of receipt, and (4) certain private foundations the contributions to which are pooled in a common fund and the income and corpus of which are paid to public charities. The 30 percent limitation applies to private foundations (code PF), other than those previously mentioned that qualify for a 50 percent limitation, and to other organizations described in section 170(c) that do not qualify for the 50 percent limitation, such as domestic fraternal societies (code LODGE)."[351]

[349] *Topic No. 409 Capital Gains and Losses*, I.R.S. (Aug. 29, 2022), https://www.irs.gov/taxtopics/tc409.
[350] I.R.C. § 501(m)(5).
[351] *Charitable Contribution Deductions*, I.R.S. (Aug. 25, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contribution-deductions.

Term	Definition
Charitable Lead Annuity Trust (CLAT)	"In a CLAT, the trust pays a uniform payment to the charity. A grantor establishes the trust to benefit the remainder beneficiary, as it is usually the grantor or the grantor's designee. Any property appreciation remains in the trust to benefit the remainder beneficiary."[352]
Charitable Lead Trust (CLT)	"This is a split-interest trust that annually pays a fixed annuity or unitrust amount to a charitable organization for the lead period specified in the trust instrument. The lead period may be a term of years or it may be a period determined by the lifetime of one or more individuals . . . . The donor to the trust will have been allowed a deduction under one of the sections listed in section 4947(a)(2). At the end of the lead period, annual payments to the charitable organization cease, and the remaining corpus becomes payable, outright or in trust, to a noncharitable (private) beneficiary."[353]
Charitable Limited Liability Company	"If the sole owner of a disregarded limited liability company is a tax-exempt organization described in section 501(a) of the Code, then the limited liability company is treated as a component part of the exempt organization. In such a situation, the exempt owner of the disregarded limited liability company generally must treat the operations of the limited liability company as a branch or division of the owner and include, as the owner's own, information pertaining to the finances and operations of the limited liability company in filing an annual information return as required under section 6033 of the Code. As a general rule, a disregarded limited liability company whose sole owner is exempt from federal income tax under section 501(a) of the Code is not required to pay federal taxes or file a federal tax or information return; that is the responsibility of its sole owner. The disregarded entity generally receives the benefit of its owner's tax-exempt status, including exemption from federal income tax, federal unemployment tax, and other federal taxes where applicable."[354]
Charitable Remainder Annuity Trusts (CRAT)	"A charitable remainder annuity trust (CRAT) is a charitable remainder trust in which the income payments to the non-charitable beneficiary are fixed throughout the life of the trust. The trustee(s) calculate the payment amount by multiplying the designated percentage by the fair market value of the assets initially placed in the trust."[355] "The amount is at least 5% and no more than 50% of the value of the corpus (property in the trust) when the trust is established."[356]

[352] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 1, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[353] *Instructions for Form 5227 (2021)*, I.R.S. (Dec. 22, 2021), https://www.irs.gov/instructions/i5227.
[354] I.R.S. Information Letter 2010-0052 (Mar. 15, 2010)
[355] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 1, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[356] *Charitable Remainder Trusts*, I.R.S. (Aug. 22, 2022), https://www.irs.gov/charities-non-profits/charitable-remainder-trusts.

Term	Definition
Charitable Remainder Trust	"Charitable remainder trusts (CRT) are split-interest trusts in which a noncharitable beneficiary receives a stream of income for the duration of the trust, and a designated charity receives the remaining trust assets upon termination. Charitable remainder trusts can be either annuity trusts or unitrusts, depending on the method used to calculate the payment amounts. Further, unitrusts can be of the net income or net income with makeup variety."[357] "In a charitable remainder trust: • A donor transfers property, cash or other assets into an irrevocable trust • The trust's basis in the transferred assets is carryover basis, which is the same basis that it would be in the hands of the donor, for assets transferred to the trust during the lifetime of the donor • The trust pays income to at least 1 living beneficiary • The payments continue for a specific term of up to 20 years or the life of 1 or more beneficiaries • At the end of the payment term, the remainder of the trust passes to 1 or more qualified U.S. charitable organizations • The remainder donated to charity must be at least 10% of the initial net fair market value of all property placed in the trust Charitable remainder trusts are irrevocable. Assets that go in can't be taken back. There are 2 types of charitable remainder trusts based on how they pay beneficiaries [Charitable Remainder Annuity Trusts and Charitable Remainder Unitrusts]. Both types of trusts can be made while the donor is alive (inter vivos) or upon death (testamentary)."[358]
Charitable Remainder Unitrust (CRUT)	"A charitable remainder unitrust (CRUT), also called a unitrust, is a charitable remainder trust in which the income payments to the non-charitable beneficiary fluctuate with the fair market value of the assets in the trust. The trustee(s) calculate the payment amount by multiplying the designated percentage (called the unitrust percentage) by the fair market value of the assets, as they are valued each year. Unitrusts can have net income or net income with makeup provisions."[359] "A charitable remainder unitrust (CRUT) pays a percentage of the value of the trust each year to noncharitable beneficiaries. The payments generally must equal at least 5% and no more than 50% of the fair market value of the assets, valued annually."[360]

[357] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[358] *Charitable Remainder Trusts*, I.R.S. (Aug. 22, 2022), https://www.irs.gov/charities-non-profits/charitable-remainder-trusts.
[359] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[360] *Charitable Remainder Trusts*, I.R.S. (Aug. 22, 2022), https://www.irs.gov/charities-non-profits/charitable-remainder-trusts.

Church	Although neither the Code nor the Regulations provide a definition of "church," not all religious entities qualify as churches within the meaning of § 170. Proposed regulations have introduced definitions of the term, only to remove the definition when the final regulations were published. The Supreme Court has also never defined these terms for purposes of the Internal Revenue Code, likely due to constitutional concerns. Although the term "church" is historically associated with Christianity, for purposes of the Internal Revenue Code, the term incorporates a 501(c)(3) organization that is organized and operated for "religious purposes," including those of any religion. Defining "religion" and "religious purposes" is therefore also of issue. The Supreme Court has not defined "religion" for purposes of the Internal Revenue Code and has been careful when defining it in other contexts, tending to examine the sincerity of religious belief rather than the doctrine espoused by the religion. The IRS published a Technical Advice Memorandum in 1995 that included the following 14 factors, based upon case law, that it considers to be helpful when determining whether a religious organization is a church: 1) A distinct legal existence; 2) A recognized creed and form of worship; 3) A definite and distinct ecclesiastical government; 4) A formal code of doctrine and discipline; 5) A distinct religious history; 6) Membership not associated with any other church or denomination; 7) Ordained ministers; 8) Selection of ministers for ordination after prescribed studies; 9) Its own literature; 10) Established places of worship; 11) Regular congregations; 12) Regular religious services; 13) "Sunday School" for instructing children; and 14) Schools for preparing clergy. The Tax Court has also helped to define "church." In its 1987 opinion, Foundation of Human Understanding v. Commissioner, the Tax Court provided the following discussion of the term: > Although every church may be a religious organization, not every religious organization is a church. To classify a religious organization as a church under the Internal Revenue Code, we should look to its religious purposes and, particularly, the means by which its religious purposes are accomplished. "The means by which an avowedly religious purpose is accomplished separates a 'church' from other forms of religious enterprise. * * * At a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship." When bringing people

Term	Definition
	together for worship is only an incidental part of the activities of a religious organization, those limited activities are insufficient to label the entire organization a church. The Tax Court has not adopted the 14 factors above as a formal test but has used the factors in its analysis when determining whether a religious organization qualifies as a church.

Term	Definition
Community Benefit Standard	"The community benefit standard, as outlined in Rev. Rul. 69-545, is a test the IRS uses to determine whether a hospital is organized and operated for the charitable purpose of promoting health. Rev. Rul. 69-545 provides examples illustrating whether a hospital is described under Section 501(c)(3). Section 501(c)(3) provides exempt status for organizations that are, in general, religious, charitable, scientific, literary or educational. The promotion of health is not a specifically enumerated purpose within Section 501(c)(3). However, it is one of the purposes in the general law of charity that is deemed to be beneficial to the community as a whole, even though the class of beneficiaries eligible to receive a direct benefit from its activities does not necessarily include all members of the community. Therefore, to qualify as an organization described in Section 501(c)(3), a hospital must: • Demonstrate that it provides benefits to a class of persons that is broad enough to benefit the community, and • Operate to serve a public rather than a private interest. Rev. Rul. 69-545 provides the following factors that demonstrate community benefit: • Operating an emergency room open to all, regardless of ability to pay • Maintaining a board of directors drawn from the community • Maintaining an open medical staff policy • Providing hospital care for all patients able to pay, including those who pay their bills through public programs such as Medicaid and Medicare • Using surplus funds to improve facilities, equipment, and patient care; and • Using surplus funds to advance medical training, education, and research. Rev. Rul. 56-185, modified by Rev. Rul. 69-545, set forth more restrictive requirements for exemption of hospitals under Section 501(c)(3). Those more restrictive requirements included patient care without charge or at rates below cost. Though a hospital is no longer required to operate under those requirements, doing so continues to be a significant factor indicating that the hospital is operated for the benefit of the community. Although no one factor is determinative in considering whether a nonprofit hospital meets the community benefit standard, the IRS weighs all the relevant facts and circumstances in evaluating these factors. Additional factors, such as whether a hospital provides financial assistance to those not able to pay, are relevant in determining whether the hospital is providing a benefit to the community."[361]

[361] *Charitable Hospitals - General Requirements for Tax-Exemption Under Section 501(c)(3)*, I.R.S. (July 15, 2022), https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3.

Term	Definition
Community Foundation	"The primary purpose of both trust-form and corporate-form community foundations is to provide charitable support to their local communities. They do this by building endowments with contributions from local residents, and administering them for the benefit of their communities. They also administer non-endowment funds. . . . Community foundations are akin to holding companies. Both forms are composite organizations that administer an accumulation of various trusts and funds. Typically, these foundations do not themselves hold the trusts and funds; rather, they are held in and managed by banks and trust companies within the community. . . . Usually, community foundations are non-operating charities. They do not operate museums, run homeless shelters, maintain community parks, or perform other services. They do charity by providing grants and gifts to local charities and charitable community projects. Their organized efforts to collect and distribute funds greatly benefit their local communities."[362]
Complex Trust	"A 'complex trust' is a trust that is not defined as a "simple trust" or a "grantor trust" under the Internal Revenue Code."[363] "Complex trusts may accumulate income, distribute amounts other than current income and, make deductible payments for charitable purposes under IRC Section 642(c)."[364]

[362] George Johnson & David Jones, *K. COMMUNITY FOUNDATIONS*, I.R.S. (1994), https://www.irs.gov/pub/irs-tege/eotopick94.pdf.
[363] *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.
[364] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.

Term	Definition
Convention or Association of Churches	Determining whether a 501(c)(3) organization qualifies as a convention or association of churches also requires examining case law because the Code does not define "convention or association" for purposes of this Section. The only additional guidance provided by the Code is Section 7701(n), which provides that "any organization which is otherwise a convention or association of churches shall not fail to so qualify merely because the membership of such organization includes individuals as well as churches or because individuals have voting rights in such organization." The legislative history of Congress's use of the phrase indicates that it was added at the urging of Baptist leaders who were concerned that by not distinguishing between "churches" and "conventions or associations" of churches, the statute would be unclear regarding whether independent congregational churches would qualify as "churches." By distinguishing "churches" from "conventions or associations" of churches, Congress made clear that the term included both hierarchical church denominations as well as independent congregational churches. Revenue Ruling 74-224, 1974-1 C.B. 61, addressed whether a convention or association of churches can be made up of churches from multiple denominations. While acknowledging that the term "has a historical meaning generally referring to a cooperative undertaking by churches of the same denomination," the IRS concluded that "nothing in the legislative or religious history of the term prevents its application to a cooperative undertaking by churches of differing denominations . . . . The term is not limited in its application to a group of churches of the same denomination."
Corpus (or Principal)	"The corpus (or principal) of a trust consists of the original assets transferred into the trust. Often referred to as the body of the trust, the corpus may generate income streams."[365]

[365] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.

Term	Definition
Disqualified Person	"A disqualified person is any person who was in a position to exercise substantial influence over the affairs of the applicable tax-exempt organization at any time during the lookback period. It is not necessary that the person actually exercise substantial influence, only that the person be in a position to do so. . . . Family members of the disqualified person and entities controlled by the disqualified person are also disqualified persons. For this purpose, the term control is defined as owning more than 35 percent of the voting power of a corporation, more than 35 percent of the profits interest in a partnership, or more than 35 percent of the beneficial interest in a trust."[366] "A disqualified person is any of the following. 8. A substantial contributor. 9. A foundation manager. 10. A person who owns more than 20% of a corporation, partnership, trust, or unincorporated enterprise, which is itself a substantial contributor. 11. A member of the family of an individual in the first three categories. 12. A corporation, partnership, trust, or estate in which persons described in (1), (2), (3), or (4) above own a total beneficial interest of more than 35%. 13. For purposes of section 4943 (excess business holdings), a disqualified person also includes: a. A private foundation which is effectively controlled (directly or indirectly) by the same persons who control the trust in question, or b. A private foundation substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in (1), (2), or (3) above, or members of their families, within the meaning of section 4946(d), who made (directly or indirectly) substantially all of the contributions to the trust in question. 14. For purposes of section 4941 (self-dealing), a disqualified person also includes certain government officials."[367]
Donor Advised Fund	"Generally, a donor advised fund is a separately identified fund or account that is maintained and operated by a section 501(c)(3) organization, which is called a sponsoring organization. Each account is composed of contributions made by individual donors. Once the donor makes the contribution, the organization has legal control over it. However, the donor, or the donor's representative, retains advisory privileges with respect to the distribution of funds and the investment of assets in the account."[368]
Electing Small Business Trust (ESBT)	"An ESBT is a statutory creature established by IRC Section 641(c). By meeting the requirements of an ESBT, a trust may own S Corporation shares. ESBT's must file Form 1041 and the S Corporation income is taxed at the trust's highest marginal rate. No income distribution deduction is allowed to beneficiaries. To be treated as an ESBT, an election must be made."[369]

[366] *Disqualified Person - Intermediate Sanctions*, I.R.S. (Aug. 1, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/disqualified-person-intermediate-sanctions.
[367] *Instructions for Form 5227 (2021)*, I.R.S. (Dec. 22, 2021), https://www.irs.gov/instructions/i5227.
[368] *Donor-advised Funds*, I.R.S. (Aug. 1, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/donor-advised-funds.
[369] *Abusive Trust Tax Evasion Schemes - Special Types of Trusts*, I.R.S. (Jan. 7, 2022),

Term	Definition
Estate Administration Exception	"Treas. Reg. 53.4941(d)-1(b)(3) states that the term 'indirect self-dealing' shall not include a transaction with respect to a private foundation's interest or expectancy in property (whether or not encumbered) held by an estate (or revocable trust, including a trust which has become irrevocable on a grantor's death), regardless of when title to the property vests under local law, if certain requirements are satisfied. The sale or exchange of property to a disqualified person while held by an estate or trust in which a foundation has an interest or expectancy may be an act of indirect self-dealing. However, a transaction involving a private foundation's interest or expectancy in property held by an estate (or revocable trust, including a trust that has become irrevocable on a grantor's death), regardless of when title to the property vests under local law, is not indirect self-dealing if the requirements under Treas. Reg. 53.4941(d)-1(b)(3) are met. The requirements of the estate administration exception set forth in Treas. Reg. 53.4941(d)-1(b)(3) are the following: • The administrator or executor of an estate or trustee of a revocable trust either (a) possesses a power of sale with respect to the property, (b) has the power to reallocate the property to another beneficiary, or (c) is required to sell the property under the terms of any option subject to which the property was acquired by the estate (or revocable trust); • Such transaction is approved by the probate court having jurisdiction over the estate (or by another court having jurisdiction over the estate (or trust) or over the private foundation); • Such transaction occurs before the estate is considered terminated for Federal income tax purposes pursuant to Treas. Reg. 1.641(b)-3(a) (or in the case of a revocable trust, before it is considered subject to IRC 4947); • The estate (or trust) receives an amount which equals or exceeds the fair market value of the foundation's interest or expectancy in such property at the time of the transaction, taking into account the terms of any option subject to which the property was acquired by the estate (or trust); and • With respect to transactions occurring after April 16, 1973, the transaction either (a) results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up, (b) results in the foundation receiving an asset related to the carrying out of its exempt purposes, or (c) is required under the terms of any option which is binding on the estate (or trust). If the sale or exchange of property to a disqualified person while held by an estate or trust in which a foundation has an interest or expectancy meets the requirements for the estate administration exception (as described above), the transaction will not be considered an act of indirect self-dealing under IRC 4941."[370]

https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-special-types-of-trusts.

[370] *Private Foundations: Estate Administration Exception to Indirect Self-Dealing Under Treas. Reg. 53.4941(d)-1(b)(3)*, I.R.S. (Mar. 31, 2022), https://www.irs.gov/charities-non-profits/private-foundations-estate-administration-exception-to-indirect-self-dealing-under-treas-reg-534941d-1b3.

Term	Definition
Estate Tax	"The Estate Tax is a tax on your right to transfer property at your death. It consists of an accounting of everything you own or have certain interests in at the date of death . . . . The fair market value of these items is used, not necessarily what you paid for them or what their values were when you acquired them. The total of all of these items is your 'Gross Estate.' The includible property may consist of cash and securities, real estate, insurance, trusts, annuities, business interests and other assets. Once you have accounted for the Gross Estate, certain deductions (and in special circumstances, reductions to value) are allowed in arriving at your 'Taxable Estate.' These deductions may include mortgages and other debts, estate administration expenses, property that passes to surviving spouses and qualified charities. The value of some operating business interests or farms may be reduced for estates that qualify. After the net amount is computed, the value of lifetime taxable gifts (beginning with gifts made in 1977) is added to this number and the tax is computed. The tax is then reduced by the available unified credit. Most relatively simple estates (cash, publicly traded securities, small amounts of other easily valued assets, and no special deductions or elections, or jointly held property) do not require the filing of an estate tax return. A filing is required for estates with combined gross assets and prior taxable gifts exceeding . . . $12,060,000 in 2022."[371]
Excess Benefit Transaction	"The term 'excess benefit transaction' means any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit."[372]

[371] *Estate Tax*, I.R.S. (July 28, 2022), https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax.
[372] I.R.C. § 4958(c)(1)(A).

Term	Definition
Excess Business Holdings	"The excess business holdings of a foundation are the amount of stock or other interest in a business enterprise that exceeds the permitted holdings. A private foundation is generally permitted to hold up to 20 percent of the voting stock of a corporation, reduced by the percentage of voting stock actually or constructively owned by disqualified persons. There are two exceptions to this rule. 1. If one or more third persons, who are not disqualified persons, have effective control of a corporation, the private foundation and all disqualified persons together may own up to 35 percent of the corporation's voting stock. Effective control means the power, whether direct or indirect, and whether or not actually exercised, to direct or cause the direction of the management and policies of a business enterprise. It is the actual control which is decisive, and not its form or the means by which it is exercisable. 2. A private foundation is not treated as having excess business holdings in any corporation in which it (together with certain other related private foundations) owns not more than two percent of the voting stock and not more than two percent of the value of all outstanding shares of all classes of stock. Nonvoting stock (or capital interest for holdings in a partnership or joint venture) is a permitted holding of a foundation if all disqualified persons together hold no more than 20 percent (or 35 percent as described earlier) of the voting stock of the corporation. All equity interests which are not voting stock shall be classified as nonvoting stock."
Facts and Circumstances Test	"If [an] organization receives more than 10 percent but less than 33-1/3 percent of its support from the general public or a governmental unit, it can qualify as a public charity if it can establish that, under all the facts and circumstances, it normally receives a substantial part of its support from governmental units or the general public."[373]
Fair Market Value (FMV)	"Fair market value (FMV) is the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts. If you put a restriction on the use of property you donate, the FMV must reflect that restriction."[374]
First-Bite Rule	A transaction that occurs between a Private Foundation and a Disqualified Person will not be classified as an act of self-dealing if the status of Disqualified Person arises only as a result of such transaction.

[373] *Exempt Organizations Annual Reporting Requirements - Form 990, Schedules A and B: "Facts and Circumstances" Public Support Test*, I.R.S. (July 27, 2022), https://www.irs.gov/charities-non-profits/exempt-organizations-annual-reporting-requirements-form-990-schedules-a-and-b-facts-and-circumstances-public-support-test.

[374] *Publication 561 (01/2022), Determining the Value of Donated Property*, I.R.S. (Jan. 24, 2022), https://www.irs.gov/publications/p561#en_US_202109_publink1000257933.

Term	Definition
Flip NIMCRUT	"This trust starts out as either a NICRUT or a NIMCRUT. When a specific event occurs, as spelled out in the trust document, it 'flips' or converts automatically to a straight fixed percentage unitrust. Treas. Reg. 1.664-3(a)(1)(i)(c) provides the authority for the flip provision. Specifically, that regulation permits the net income method for a unitrust for an initial period and then a fixed percentage amount for the trust's remaining period only if the governing instrument provides for certain conditions. These conditions include the requirement that the change in unitrust payment method is triggered on a specific date or by a single event whose occurrence isn't discretionary with, or in the control of, the trustees or any other persons. Treas. Reg. 1.664-3(a)(1)(i)(d), while not an all-inclusive list, gives some permissible triggering events: the sale of unmarketable assets and the marriage, divorce, death, or birth of a child, because they aren't considered to be discretionary with any person. A trust's reformation to add a flip provision could result in a self-dealing transaction under IRC Section 4941 unless there is authority to do so. A flip qualifying under the requirements of the IRC Section 664 regulations won't constitute an act of self-dealing, including trust document reformations occurring under the effective date provisions of Treas. Reg. 1.664-3(a)(1)(i)(f)."[375]
Foundation Manager	"A foundation manager is an officer, director, or trustee (or an individual who has powers or responsibilities similar to those of officers, directors, or trustees). In the case of any act or failure to act, the term 'foundation manager' may also include an employee of the trust who has the authority to act."[376]
Gift Tax	"The gift tax is a tax on the transfer of property by one individual to another while receiving nothing, or less than full value, in return. The tax applies whether or not the donor intends the transfer to be a gift. The gift tax applies to the transfer by gift of any type of property. You make a gift if you give property (including money), or the use of or income from property, without expecting to receive something of at least equal value in return. If you sell something at less than its full value or if you make an interest-free or reduced-interest loan, you may be making a gift."[377]
Grant-Making	This means writing checks to charities. Privation Foundations typically transfer monies to established Public Charities, as opposed to engaging in charitable activities. A grant is simply a check written to transfer money from one charity to another.

[375] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 10, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[376] *Instructions for Form 5227 (2021)*, I.R.S. (Dec. 22, 2021), https://www.irs.gov/instructions/i5227.
[377] *Gift Tax*, I.R.S. (Feb. 4, 2022), https://www.irs.gov/businesses/small-businesses-self-employed/gift-tax.

Term	Definition
Grantor	"The grantor (also known as trustor, settlor, or creator) is the creator of the trust relationship and is generally the owner of the assets initially contributed to the trust. The grantor generally establishes in the trust instrument the terms and provisions of the trust relationship between the grantor, the trustee, and the beneficiary. These will usually include the following: • The rights, duties, and powers of the trustee; • Distribution provisions; • Ability of the grantor to amend, modify, revoke, or terminate the trust agreement; • The designation and selection of a trustee or successor trustees; and • The designation of the state under which the terms and provisions of the trust agreement are to be governed."[378]
Grantor Trust	"'Grantor trust' is a term used in the Internal Revenue Code to describe any trust over which the grantor or other owner retains the power to control or direct the trust's income or assets. If a grantor retains certain powers over or benefits in a trust, the income of the trust will be taxed to the grantor, rather than to the trust. (Examples, the power to decide who receives income, the power to vote or to direct the vote of the stock held by the trust or to control the investment of the trust funds, the power to revoke the trust, etc.) All "revocable trusts" are by definition grantor trusts. An "irrevocable trust" can be treated as a grantor trust if any of the grantor trust definitions contained in Internal Code §§ 671, 673, 674, 675, 676, or 677 are met. If a trust is a grantor trust, then the grantor is treated as the owner of the assets, the trust is disregarded as a separate tax entity, and all income is taxed to the grantor."[379]
Income beneficiary	"The income beneficiary of a split-interest trust is the recipient of the stream of payments made over the duration of the trust. The income beneficiary of charitable remainder trusts and pooled income funds is the non-charitable beneficiary. In charitable lead trusts, the income beneficiary is the designated charitable organization."[380]
Income Interest	"Income interest includes an interest in property transferred in trust that is (1) a guaranteed annuity interest, or (2) a unitrust interest."[381]
Individual Retirement Arrangements (IRAs)	"An individual retirement arrangement (IRA) is a tax-favored personal savings arrangement, which allows you to set aside money for retirement. There are several different types of IRAs, including traditional IRAs and Roth IRAs. You can set up an IRA with a bank, insurance company, or other financial institution."[382]

[378] *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.
[379] *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.
[380] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[381] *Split Interest Trusts: Income interest defined*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/split-interest-trusts-income-interest-defined.
[382] *Topic No. 451 Individual Retirement Arrangements (IRAs)*, I.R.S. (July 29, 2022), https://www.irs.gov/taxtopics/tc451.

Term	Definition
Integrated Auxiliaries of Churches	Although IRC § 170 does not use the term "integrated auxiliary of a church," IRC § 6033 provides that "integrated auxiliaries of a church" are exempt from filing Form 990, *Return of Organization Exempt From Income Tax* (see section on tax benefits below). Treasury Regulation § 1.6033-2(h) defines the term as an organization that meets the following requirements. The organization must be: — Described both in sections 501(c)(3) and 509(a)(1), (2), or (3); — Affiliated with a church or a convention or association of churches; and — Internally supported. An organization is affiliated with a church or a convention or association of churches . . . if-- — The organization is covered by a group exemption letter issued under applicable administrative procedures . . . to a church or a convention or association of churches; — The organization is operated, supervised, or controlled by or in connection with . . . a church or a convention or association of churches; or — Relevant facts and circumstances show that it is so affiliated. . . . An organization is internally supported . . . unless it both— — Offers admissions, goods, services or facilities for sale, other than on an incidental basis, to the general public (except goods, services, or facilities sold at a nominal charge or for an insubstantial portion of the cost); and — Normally receives more than 50 percent of its support from a combination of governmental sources, public solicitation of contributions, and receipts from the sale of admissions, goods, performance of services, or furnishing of facilities in activities that are not unrelated trades or businesses. The Regulation lists "[m]en's and women's organizations, seminaries, mission societies, and youth groups" as organizations that meet its definition of "integrated auxiliary of a church."

Term	Definition
Inter Vivos (During Life) Trust	"An inter vivos trust is a trust that is created and takes effect during the grantor's lifetime."[383] "An Inter Vivos trust can be established as revocable or irrevocable. An Inter Vivos trust can be a simple, complex, or grantor trust depending on the trust instrument."[384]
Inurement	"Inurement is a subset of private benefit that involve unjust benefit from the income or assets of an exempt organization going to insiders."[385] "IRC 501(c)(3) expressly provides that to qualify for exemption, no part of an organization's net earnings shall inure in whole or in part to the benefit of private shareholders or individuals."[386]
Irrevocable Trust	"An irrevocable trust is a trust, which, by its terms, cannot be modified, amended, or revoked. For tax purposes an irrevocable trust can be treated as a simple, complex, or grantor trust, depending on the powers listed in the trust instrument. State law and the trust instrument establish whether a trust is revocable or irrevocable. If the trust instrument is silent on revocability, then most states consider the trust revocable."[387]
IRS Private Letter Ruling (PLR)	"A private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's represented set of facts. A PLR is issued in response to a written request submitted by a taxpayer. A PLR may not be relied on as precedent by other taxpayers or by IRS personnel."[388]
Itemized deductions	"Itemized deductions are subtractions from a taxpayer's Adjusted Gross Income (AGI) that reduce the amount of income that is taxed. Most taxpayers have a choice of taking a standard deduction or itemizing deductions. Taxpayers should use the type of deduction that results in the lowest tax."[389]

383 *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
384 *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.
385 *Health Care Provider Reference Guide*, I.R.S., 2004 EO CPE Text, https://www.irs.gov/pub/irs-tege/eotopicc04.pdf
386 *Health Care Provider Reference Guide*, I.R.S., 2004 EO CPE Text, https://www.irs.gov/pub/irs-tege/eotopicc04.pdf
387 *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.
388 *Tax Exempt Bonds Private Letter Rulings: Some Basic Concepts*, I.R.S. (Aug. 16, 2022), https://www.irs.gov/tax-exempt-bonds/teb-private-letter-ruling-some-basic-concepts.
389 *Itemized Deductions*, I.R.S., 20-1, https://apps.irs.gov/app/vita/content/globalmedia/4491_itemized_deductions.pdf.

Term	Definition
Limited Liability Company	"A Limited Liability Company (LLC) is an entity created by state statute. Depending on elections made by the LLC and the number of members, the IRS will treat an LLC either as a corporation, partnership, or as part of the owner's tax return (a disregarded entity). A domestic LLC with at least two members is classified as a partnership for federal income tax purposes unless it files Form 8832 and elects to be treated as a corporation. For income tax purposes, an LLC with only one member is treated as an entity disregarded as separate from its owner, unless it files Form 8832 and elects to be treated as a corporation. However, for purposes of employment tax and certain excise taxes, an LLC with only one member is still considered a separate entity."[390]
Medical research to be conducted by a Medical Research Organization in conjunction with a hospital	"Medical research means the conduct of investigations, experiments, and studies to discover, develop, or verify knowledge relating to the causes, diagnosis, treatment, prevention, or control of physical or mental diseases and impairments of man. To qualify as a medical research organization, the organization must have or must have continuously available for its regular use the appropriate equipment and professional personnel necessary to carry out its principal function. Medical research encompasses the associated disciplines spanning the biological, social and behavioral sciences. Such disciplines include chemistry (biochemistry, physical chemistry, bioorganic chemistry, etc.), behavioral sciences (psychiatry, physiological psychology, neurophysiology, neurology, neurobiology, and social psychology, etc.), biomedical engineering (applied biophysics, medical physics, and medical electronics, for example, developing pacemakers and other medically related electrical equipment), virology, immunology, biophysics, cell biology, molecular biology, pharmacology, toxicology, genetics, pathology, physiology, microbiology, parasitology, endocrinology, bacteriology, and epidemiology."[391]
Net Income Charitable Remainder Unitrust (NICRUT)	"Net income charitable remainder unitrusts are charitable remainder unitrusts that allow the annual payment to the non-charitable beneficiary to be the lesser of either the unitrust amount or the trust's net income."[392]
Net Income With Makeup Charitable Remainder Unitrusts (NIMCRUT)	"A net income with makeup charitable remainder unitrust allows the payment to the non-charitable beneficiary to be the lesser of the unitrust amount or the accounting income, however any deficiencies must be repaid when income allows. Deficiencies in the distributions, which occur when the net income is less than the unitrust payment amount, accrue year-to-year and are made up in subsequent years when the net income of the trust is greater than the unitrust amount."[393]

[390] *LLC Filing as a Corporation or Partnership*, I.R.S. (Nov. 10, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/llc-filing-as-a-corporation-or-partnership.
[391] 26 C.F.R. § 1.170A-9(d)(iii) (2020).
[392] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[393] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 2, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.

Term	Definition
Partnership	"An unincorporated organization with two or more members is generally classified as a partnership for federal tax purposes if its members carry on a trade, business, financial operation, or venture and divide its profits. However, a joint undertaking merely to share expenses is not a partnership. For example, co-ownership of property maintained and rented or leased is not a partnership unless the co-owners provide services to the tenants."[394] "A partnership must file an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it does not pay income tax. Instead, it "passes through" profits or losses to its partners. Each partner reports their share of the partnership's income or loss on their personal tax return."[395]
Personal Services Exception	The self-dealing rules include an exception that permits a Private Foundation to pay compensation to a Disqualified Person (other than a government official) for personal services rendered to the Private Foundation. The services rendered by the Disqualified Person (who does not have to be an individual) must be: 1. Personal services, 2. Reasonable, 3. Necessary to carrying out the exempt purpose of the Private Foundation, and 4. Executive and professional in nature as opposed to being "blue collar."
Pooled Income Fund	"A pooled income fund is an unincorporated fund set up by a public charity to which a person transfers property, reserving an income interest in, and giving the charity the remainder interest in that property."[396]
Pooled Income Fund Trust	A type of split-interest trust that "allow[s] donors to donate assets to a charity. The pooled assets are invested as a group and each donor receives income based on the ratio of his or her contribution to the total value of the investment pool. After the death of the donor, his or her prorated share of the investment pool is withdrawn and given to the charitable organization."[397]

[394] *Publication 541 (03/2022)*, Partnerships, I.R.S. (Mar. 30, 2022), https://www.irs.gov/publications/p541.
[395] *Tax Information For Partnerships*, I.R.S. (Dec. 7, 2021), https://www.irs.gov/businesses/partnerships.
[396] *Abusive Trust Tax Evasion Schemes - Special Types of Trusts*, I.R.S. (Jan. 7, 2022), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-special-types-of-trusts.
[397] *SOI Tax Stats - Split-Interest Trust Statistics*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/statistics/soi-tax-stats-split-interest-trust-statistics.

Term	Definition
Private Benefit	"A section 501(c)(3) organization must not be organized or operated for the benefit of private interests, such as the creator or the creator's family, shareholders of the organization, other designated individuals, or persons controlled directly or indirectly by such private interests. No part of the net earnings of a section 501(c)(3) organization may inure to the benefit of any private shareholder or individual. A private shareholder or individual is a person having a personal and private interest in the activities of the organization."[398] Incidental private benefit does not disqualify an organization from exempt status. Private benefits must be both qualitatively and quantitatively incidental. Qualitatively incidental means the private benefit is a mere byproduct of the public benefit. Quantitatively incidental means that the private benefit granted as a result of the specific activity must be insubstantial in amount when compared to the public benefit for the same specific activity.[399]
Private Foundation	One of two classes of 501(c)(3) organizations, along with Public Charities. "In general, a private foundation is any section 501(c)(3) organization that does not fall into one of the categories specifically excluded from the definition of that term ['public charities']. Some tax law provisions apply to all private foundations. Others, however, are more narrowly focused on particular types of private foundations. Moreover, special rules apply to certain private foundations, and to organizations that are not private foundations and certain non-exempt entities. For tax purposes, it may be necessary to distinguish between the following types of foundations: 4. Private operating foundations 5. Exempt operating foundations 6. Grant-making (private nonoperating) foundations"[400] "Private foundations . . . typically have a single major source of funding (usually gifts from one family or corporation rather than funding from many sources) and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs."[401]

[398] *Inurement/Private Benefit - Charitable Organizations*, I.R.S. (Jan. 1, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/inurement-private-benefit-charitable-organizations.

[399] *Health Care Provider Reference Guide*, I.R.S., 2004 EO CPE Text, https://www.irs.gov/pub/irs-tege/eotopicc04.pdf

[400] *Types of Foundations*, I.R.S. (Aug. 17, 2022), https://www.irs.gov/charities-non-profits/private-foundations/types-of-foundations.

[401] *Public Charities*, I.R.S. (June 16, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/public-charities.

Term	Definition
Private Non-Operating Foundation	"A private foundation that is neither a private operating foundation nor an exempt operating foundation[402] is sometimes referred to as a grant-making foundation or a private nonoperating foundation."[403]
Private Operating Foundation	"A private operating foundation is any private foundation that spends at least 85 percent of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of its exempt activities (the income test)."[404] "A private operating foundation is not subject to the tax on net investment income if it is an exempt operating foundation. In addition, private foundations may make grants to exempt operating foundations without complying with the expenditure responsibility requirements. In general, an exempt operating foundation is a private foundation that has been publicly supported for 10 years; whose governing body consists of individuals less than 25 percent of whom are disqualified individuals and is broadly representative of the general public; and has no officer who is a disqualified individual during the year."[405]
Public Charity	One of two classes of 501(c)(3) organizations, along with Private Foundations. "Generally, organizations that are classified as public charities are those that: • Are churches, hospitals, qualified medical research organizations [acting] with hospitals, schools, colleges and universities, • Have an active program of fundraising and receive contributions from many sources, including the general public, governmental agencies, corporations, private foundations or other public charities, • Receive income from the conduct of activities in furtherance of the organization's exempt purposes, or • Actively function in a supporting relationship to one or more existing public charities [i.e., a Supporting Organization]."[406]

[402] "In general, an exempt operating foundation is a private foundation that has been publicly supported for 10 years; whose governing body consists of individuals less than 25 percent of whom are disqualified individuals and is broadly representative of the general public; and has no officer who is a disqualified individual during the year." *Exempt Operating Foundations*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/exempt-operating-foundations.

[403] *Grant-Making Foundations*, I.R.S. (Aug. 2, 2022), https://www.irs.gov/charities-non-profits/private-foundations/grant-making-foundations.

[404] *Definition of Private Operating Foundation*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/definition-of-private-operating-foundation.

[405] *Exempt Operating Foundations*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/private-foundations/exempt-operating-foundations.

[406] *Public Charities*, I.R.S. (June 16, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/public-charities.

Term	Definition
Public Support Tests	"There are two public support tests for public charities: One for organizations described in sections 509(a)(1) and 170(b)(1)(A)(vi) of the Internal Revenue Code, and one for organizations described in section 509(a)(2). Both tests measure public support over a five-year period. Generally, the 509(a)(1) test requires that the organization receive at least one-third of its support from contributions from the general public, or meet the 10 percent facts and circumstances test. Generally, the 509(a)(2) test requires that the organization receive more than one-third of its support from contributions from the general public and/or from gross receipts from activities related to its tax-exempt purposes. Under the 509(a)(2) test, an organization can receive no more than one-third of its support from gross investment income and unrelated business taxable income."[407]
Qualified Organization	A taxpayer "may deduct a charitable contribution made to, or for the use of, any of the following organizations that otherwise are qualified under section 170(c) of the Internal Revenue Code: • A state or United States possession (or political subdivision thereof), or the United States or the District of Columbia, if made exclusively for public purposes; • A community chest, corporation, trust, fund, or foundation, organized or created in the United States or its possessions, or under the laws of the United States, any state, the District of Columbia or any possession of the United States, and organized and operated exclusively for charitable, religious, educational, scientific, or literary purposes, or for the prevention of cruelty to children or animals; • A church, synagogue, or other religious organization; • A war veterans' organization or its post, auxiliary, trust, or foundation organized in the United States or its possessions; • A nonprofit volunteer fire company; • A civil defense organization created under federal, state, or local law (this includes unreimbursed expenses of civil defense volunteers that are directly connected with and solely attributable to their volunteer services); • A domestic fraternal society, operating under the lodge system, but only if the contribution is to be used exclusively for charitable purposes; • A nonprofit cemetery company if the funds are irrevocably dedicated to the perpetual care of the cemetery as a whole and not a particular lot or mausoleum crypt."[408]
Qualified Subchapter S Trust (QSST)	"A QSST is a statutory creature established by IRC Section 1361(d)(3). By meeting the requirements of a QSST, a trust may own S Corporation shares. An election must be made to be treated as a QSST and once made is irrevocable."[409]

[407] *Exempt Organizations Annual Reporting Requirements - Form 990, Schedules A and B: Public Charity Support Test*, I.R.S. (May 4, 2022), https://www.irs.gov/charities-non-profits/exempt-organizations-annual-reporting-requirements-form-990-schedules-a-and-b-public-charity-support-test.
[408] *Charitable Contribution Deductions*, I.R.S. (Aug. 25, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contribution-deductions.
[409] *Abusive Trust Tax Evasion Schemes - Special Types of Trusts*, I.R.S. (Jan. 7, 2022), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-special-types-of-

Term	Definition
Quid Pro Quo Contributions	"This is a payment a donor makes to a charity partly as a contribution and partly for goods or services. For example, if a donor gives a charity $100 and receives a concert ticket valued at $40, the donor has made a quid pro quo contribution. In this example, the charitable contribution part of the payment is $60. Even though the deductible part of the payment is not more than $75, a disclosure statement . . . must be provided by the organization to the donor because the donor's payment (quid pro quo contribution) is more than $75. Failure to make the required disclosure may result in a penalty . . . to the organization."[410]

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[410] *Charitable Contributions - Quid Pro Quo Contributions*, I.R.S. (Aug. 1, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contributions-quid-pro-quo-contributions.

Term	Definition
Related Party	(1) "Members of a family, . . . ;"[411] a. "Your spouse, b. Your brothers and sisters, c. Your half brothers and half sisters, d. Your ancestors (parents, grandparents, etc.), e. Your lineal descendants (children, grandchildren, etc.)"[412] (2) "An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual; (3) Two corporations which are members of the same controlled group (as defined in subsection (f)); (4) A grantor and a fiduciary of any trust; (5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts; (6) A fiduciary of a trust and a beneficiary of such trust; (7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts; (8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust; (9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual; (10) A corporation and a partnership if the same persons own— (A) more than 50 percent in value of the outstanding stock of the corporation, and (B) more than 50 percent of the capital interest, or the profits interest, in the partnership; (11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation; (12) An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or (13) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate."[413]
Remainder Beneficiary (or Remainderman)	"The remainder beneficiary of a split-interest trust is the recipient of the trust's assets at the conclusion of the trust. In the case of charitable remainder trusts, the remainder beneficiary is the selected charity; in charitable lead trusts, the remainder beneficiary is the designated private beneficiary."[414]
Remainder Interest	"Remainder interest includes an interest that succeeds an income interest."[415]

[411] I.R.C. § 267(b).
[412] *Related Person*, I.R.S., https://apps.irs.gov/app/IPAR/resources/help/loanrea.html.
[413] I.R.C. § 267(b).
[414] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 3, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[415] *Split Interest Trust: Remainder interest defined*, I.R.S. (May 4, 2022), https://www.irs.gov/charities-non-profits/private-foundations/split-interest-trust-remainder-interest-defined.

<table>
<tr><th>Term</th><th>Definition</th></tr>
<tr><td>Revocable Trust</td><td>"If the grantor retains the ability to revoke the trust and revest the trust assets in the grantor, the trust is revocable and the income is taxable to the grantor under the grantor trust rules. Assets in a revocable trust are included in the grantor's gross estate for federal estate tax purposes. Revocable trusts are also called living trusts. They are used primarily as a will substitute."[416]

"State law and the trust instrument establish whether a trust is revocable or irrevocable. If the trust instrument is silent on revocability, then most states consider the trust revocable."[417]</td></tr>
<tr><td>Roth IRA</td><td>"A Roth IRA is an IRA that, except as explained below, is subject to the rules that apply to a traditional IRA.
You cannot deduct contributions to a Roth IRA.
If you satisfy the requirements, qualified distributions are tax-free.
You can make contributions to your Roth IRA after you reach age 70 ½.
You can leave amounts in your Roth IRA as long as you live.
The account or annuity must be designated as a Roth IRA when it is set up.
The same combined contribution limit applies to all of your Roth and traditional IRAs."[418]</td></tr>
<tr><td>S Corporation</td><td>"S corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income at the entity level.

To qualify for S corporation status, the corporation must meet the following requirements:
Be a domestic corporation
Have only allowable shareholders
May be individuals, certain trusts [including Electing Small Business Trusts, even if a non-resident alien is a potential current beneficiary of the ESBT], [501(c)(3) organizations,] and [certain] estates and
May not be partnerships, corporations or non-resident alien shareholders
Have no more than 100 shareholders
Have only one class of stock
Not be an ineligible corporation (i.e. certain financial institutions, insurance companies, and domestic international sales corporations)."[419]</td></tr>
</table>

416 *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 3, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
417 *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.
418 *Roth IRAs*, I.R.S. (Aug. 2, 2022), https://www.irs.gov/retirement-plans/roth-iras.
419 *S Corporations*, I.R.S. (Sept. 2, 2022), https://www.irs.gov/businesses/small-businesses-self-employed/s-corporations.

Term	Definition
Security	"The term "security" means any— (A) share of stock in a corporation; (B) partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; (C) note, bond, debenture, or other evidence of indebtedness; (D) interest rate, currency, or equity notional principal contract; (E) evidence of an interest in, or a derivative financial instrument in, any security described in subparagraph (A), (B), (C), or (D), or any currency, including any option, forward contract, short position, and any similar financial instrument in such a security or currency; and (F) position which— (i) is not a security described in subparagraph (A), (B), (C), (D), or (E), (ii) is a hedge with respect to such a security, and (iii) is clearly identified in the dealer's records as being described in this subparagraph before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe)."[420]
Self-dealing	"The following transactions are generally considered acts of self-dealing between a private foundation and a disqualified person: • Sale, exchange, or leasing of property, • Leases (but see Certain Leases, under Exceptions to Self-Dealing) • Lending money or other extensions of credit, • Providing goods, services, or facilities, • Paying compensation or reimbursing expenses to a disqualified person, • Transferring foundation income or assets to, or for the use or benefit of, a disqualified person, and • Certain agreements to make payments of money or property to government officials. In addition, the law prohibits indirect self-dealing. Thus, transactions between organizations controlled by a private foundation may also be taxable self-dealing."[421]
Set-Asides	"An amount set aside for a specific project [by a Private Foundation] may be treated as a qualifying distribution in the year set aside (but not in the year actually paid) if at the time of the set-aside the foundation establishes to the satisfaction of the Service that: 1. The amount will actually be paid for the specific project within 60 months from the date of the first set-aside, and 2. The set-aside satisfies the suitability test, that is, that the project is one that can be better accomplished by a set-aside than by immediate payment, or the foundation satisfies the cash distribution test."[422]

[420] I.R.C. § 475(c)(2).
[421] *Acts of Self-Dealing by Private Foundation*, I.R.S. (May 4, 2022), https://www.irs.gov/charities-non-profits/private-foundations/acts-of-self-dealing-by-private-foundation.
[422] *Set-Asides*, I.R.S. (Mar. 18, 2022), https://www.irs.gov/charities-non-profits/private-foundations/set-asides.

Term	Definition
Simple trust	"'Simple trust' is a term used in the Internal Revenue Code to define a trust that: • Is not a grantor trust or required to be treated as a grantor trust; • Is required to distribute all income annually; and • Does not distribute the corpus of the trust or make charitable contributions. (IRC Section 651)."[423] "If a trust distributes corpus during a year, as in the year it terminates, the trust becomes a complex trust for that year."[424]
Single Parent Title Holding Corporation	"IRC Section 501(c)(2) describes corporations organized for the exclusive purpose of holding title to property, collecting income from it, and turning over the entire amount, less expenses, to an organization described as exempt in section IRC Section 501(a). The organization can't have unrelated business taxable income [unless an exception applies]. Also, an IRC Section 501(c)(2) organization can't retain its exemption if it accumulates its income rather than turning it over to its parent at least once a year."[425]
Split-interest trust	"Split-interest trusts make distributions to both charitable and noncharitable beneficiaries, while providing tax benefits to their donor. All split-interest trusts must annually file Form 5227, Split-Interest Trust Information Return, to report financial activity and determine if they should be treated as a private foundation. Based on the method and timing of distributions, split-interest trusts are divided into the following four categories:"[426] 1. Charitable remainder annuity trusts 2. Charitable remainder unitrusts 3. Charitable lead trusts 4. Pooled income funds
Tax deduction	"An amount (often a personal or business expense) that reduces income subject to tax."[427]
Testamentary trust	"A testamentary trust is created by a will, which begins its existence upon the death of the person making the will, when property is transferred from the decedent's estate. Testamentary trusts are generally simple or complex trusts. A testamentary trust is irrevocable by definition, as it comes into being at the death of the grantor."[428]

[423] *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.
[424] *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 3, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.
[425] *Audit Technique Guide – Single Parent Title Holding Corporations Exempt Under IRC Section 501(c)(2)*, I.R.S., 1, https://www.irs.gov/pub/irs-tege/atg_single_parent_title_hldg_co.pdf.
[426] *SOI Tax Stats - Split-Interest Trust Statistics*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/statistics/soi-tax-stats-split-interest-trust-statistics.
[427] *Understanding Taxes Glossary*, I.R.S., https://apps.irs.gov/app/understandingTaxes/student/glossary.jsp.
[428] *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.

Term	Definition
The Operational Test	In order for an organization to be tax-exempt under IRC 501(c)(3), the organization must be "operated" exclusively for exempt purposes. "An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities does not further an exempt purpose."[429]
The Organizational Test	In order for an organization to be tax-exempt under IRC 501(c)(3), the organization must be "organized" exclusively for exempt purposes. "To be organized exclusively for a charitable purpose, the organization must be a corporation (or unincorporated association), community chest, fund, or foundation. A charitable trust is a fund or foundation and will qualify. However, an individual will not qualify. The organizing documents must limit the organization's purposes to exempt purposes in section 501(c)(3) and must not expressly empower it to engage, other than as an insubstantial part of its activities, in activities that are not in furtherance of one or more of those purposes. This requirement may be met if the purposes stated in the organizing documents are limited by reference to section 501(c)(3). In addition, an organization's assets must be permanently dedicated to an exempt purpose. This means that if an organization dissolves, its assets must be distributed for an exempt purpose, to the federal government, or to a state or local government for a public purpose. To establish that an organization's assets will be permanently dedicated to an exempt purpose, its organizing documents should contain a provision ensuring their distribution for an exempt purpose in the event of dissolution. If a specific organization is designated to receive the organization's assets upon dissolution, the organizing document must state that the named organization must be a section 501(c)(3) organization when the assets are distributed. Although reliance may in some cases be placed upon state law to establish permanent dedication of assets for exempt purposes, an organization's application can be processed by the IRS more rapidly if its organizing documents include a provision ensuring permanent dedication of assets for exempt purposes."[430]
Trade or Business	"The term *trade or business* generally includes any activity carried on for the production of income from selling goods or performing services. It is not limited to integrated aggregates of assets, activities, and goodwill that comprise businesses for purposes of certain other provisions of the Internal Revenue Code. Activities of producing or distributing goods or performing services from which gross income is derived do not lose their identity as trades or businesses merely because they are carried on within a larger framework of other activities that may, or may not, be related to the organization's exempt purposes."[431]

[429] *Operational test - Internal Revenue Code section 501(c)(3)*, I.R.S. (Mar. 18, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/operational-test-internal-revenue-code-section-501c3.
[430] *Organizational Test - Internal Revenue Code Section 501(c)(3)*, I.R.S. (June 16, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/organizational-test-internal-revenue-code-section-501c3.
[431] *"Trade or Business" Defined*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/trade-or-business-

Term	Definition
Traditional IRA	"You may be able to deduct some or all of your contributions to a traditional IRA. You may also be eligible for a tax credit equal to a percentage of your contribution. Amounts in your traditional IRA, including earnings, generally aren't taxed until distributed to you. IRAs can't be owned jointly. However, any amounts remaining in your IRA upon your death will be paid to your beneficiary or beneficiaries."[432]
Trust	"A trust is an entity created and governed under the state law in which it was formed. A trust involves the creation of a fiduciary relationship between a grantor, a trustee, and a beneficiary for a stated purpose. A trust may be created by any of the following methods: • A declaration by the owner of property that the owner holds the property as trustee; • A transfer of property by the owner during the owner's lifetime to another person as trustee; • A transfer of property by the owner, by will or by other instrument taking effect upon the death of the owner, in trust, to another person as trustee or • An exercise of a power of appointment to another person as trustee or an enforceable promise to create a trust."[433]
Trust Property	"A trust must have some assets, even if only one dollar. Trust property includes assets like cash, securities, real property, tangible personal property, and life insurance policies. The assets can be either transferred during life of the grantor (inter vivos) or at his or her death (testamentary). The trust property is also referred to as the corpus, principal, estate or trust res."[434]
Trustee/fiduciary	"The trustee obtains legal title to the trust assets and is required to administer the trust on behalf of the beneficiaries according to the express terms and provisions of the trust agreement. A fiduciary is an individual or organization charged with the duty to act for the benefit of another. A trustee is a fiduciary."[435] "In the event of a breach of fiduciary duty, a trustee may be held personally liable. Such breaches include failing to pay out distributions or misappropriation. Trustees coordinate the preparation, verification, and submission of all required state and Federal tax forms and legal documents."[436]

defined.

432 *Traditional IRAs*, I.R.S. (Aug. 25, 2022), https://www.irs.gov/retirement-plans/traditional-iras.

433 *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.

434 *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 3, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.

435 *Basic Trust Law*, I.R.S. (Dec. 6, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers.

436 *Audit Technique Guide for Charitable Trusts – IRC Sections 4947(a)(1) and 4947(a)(2)*, I.R.S., 3, https://www.irs.gov/pub/irs-tege/atg_charitable_trusts.pdf.

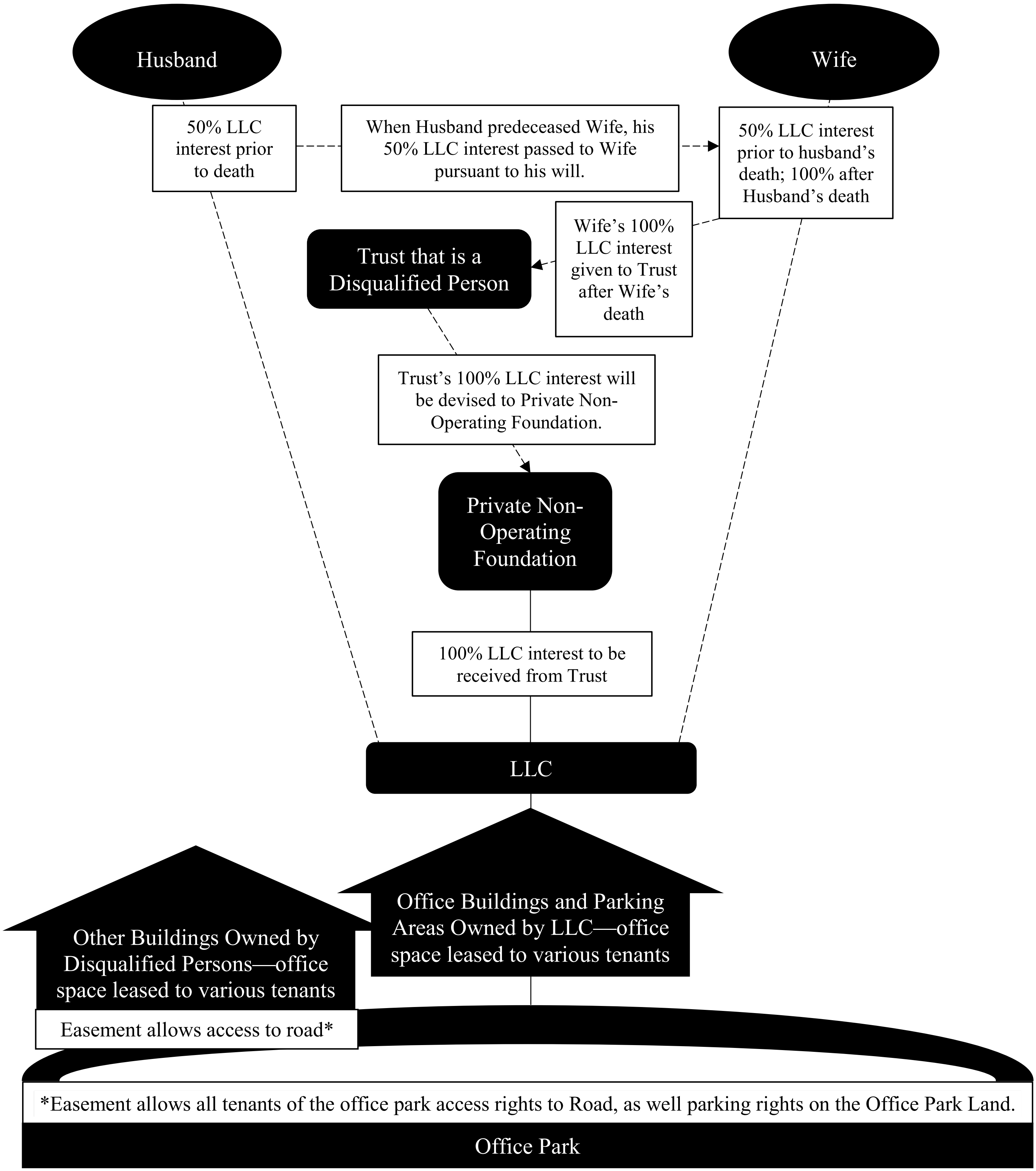
Term	Definition
Type I Supporting Organization	"A supporting organization is classified as a Type I, Type II or Type III supporting organization based on the type of relationship it has with its supported organization(s). . . . A Type I supporting organization must be operated, supervised or controlled by its supported organization(s), typically by giving the supported organization(s) the power to regularly appoint or elect a majority of the directors or trustees of the supporting organization. The relationship between the supported organization(s) and the supporting organization is sometimes described as similar to a parent-subsidiary relationship."[437]
Type II Supporting Organization	"A Type II supporting organization must be supervised or controlled in connection with its supported organization(s), typically by having a majority of the directors or trustees of the supported organization(s) serve as a majority of the trustees or directors of the supporting organization. The relationship between the supported organization(s) and the supporting organization is sometimes described as similar to a brother-sister relationship."[438]
Type III Supporting Organization	"A Type III supporting organization must be operated in connection with one or more publicly supported organizations. All supporting organizations must be responsive to the needs and demands of, and must constitute an integral part of or maintain significant involvement in, their supported organizations. Type I and Type II supporting organizations are deemed to accomplish these responsiveness and integral part requirements by virtue of their control relationships. However, a Type III supporting organization is not subject to the same level of control by its supported organization(s). Therefore, in addition to a notification requirement, Type III supporting organizations must pass separate responsiveness and integral part tests."[439]
Unrelated Business Taxable Income (UBTI)	"Even though an organization is recognized as tax exempt, it still may be liable for tax on its unrelated business income. For most organizations, unrelated business income is income from a trade or business, regularly carried on, that is not substantially related to the charitable, educational, or other purpose that is the basis of the organization's exemption. An exempt organization that has $1,000 or more of gross income from an unrelated business must file Form 990-T. An organization must pay estimated tax if it expects its tax for the year to be $500 or more."[440]

[437] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.
[438] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.
[439] *Supporting Organizations - Requirements and Types*, I.R.S. (Jan. 21, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types.
[440] *Unrelated Business Income Tax*, I.R.S. (Aug. 2, 2022), https://www.irs.gov/charities-non-profits/unrelated-business-income-tax.

<u>EXHIBIT A:</u>
PLR 201435017 (AUGUST 29, 2014)

Under this Private Letter Ruling a married couple had been in the development business for decades before creation of a private non-operating foundation.

This is in response to your ruling request, dated April 5, 2012, as modified, requesting rulings under I.R.C. §§ 512, 4941, and 4943 regarding the proposed donation of limited liability company membership interests from Decedent's estate to you.


Husband
Wife
50% LLC interest prior to death
When Husband predeceased Wife, his 50% LLC interest passed to Wife pursuant to his will.
50% LLC interest prior to husband's death; 100% after Husband's death
Wife's 100% LLC interest given to Trust after Wife's death
Trust that is a Disqualified Person
Trust's 100% LLC interest will be devised to Private Non-Operating Foundation.
Private Non-Operating Foundation
100% LLC interest to be received from Trust
LLC
Other Buildings Owned by Disqualified Persons—office space leased to various tenants
Office Buildings and Parking Areas Owned by LLC—office space leased to various tenants
Easement allows access to road*
*Easement allows all tenants of the office park access rights to Road, as well parking rights on the Office Park Land.
Office Park

FACTS

You are an irrevocable charitable trust recognized as an organization exempt from federal income tax under § 501(c)(3) and are classified as a private, non-operating foundation within the meaning of § 509(a). You were formed by Decedent and her late husband, Husband, who predeceased her.

In Date, Decedent and Husband formed a limited liability company, LLC. LLC owns office buildings on land in an office park. More than 45 years ago, prior to the development of the office park, 36 years prior to the creation of LLC, and 28 years prior to your founding, Husband recorded an easement that allows all tenants of the office park access rights to Road, as well parking rights on the office park property.

LLC leases office space in the buildings it owns to various tenants. You represent that there are no mortgages or other debt-financing on the property owned by LLC. The office park has other office buildings and land, which are owned by Disqualified Persons, within the meaning of § 4946, through various limited liability companies and trusts. Like LLC, the Disqualified Persons lease office space in their buildings to various tenants.

Decedent and Husband owned each owned fifty percent of LLC's membership interests. When Husband predeceased Decedent, his membership interests passed to Decedent pursuant to his will. After Decedent's death, all of the LLC membership interests passed to Decedent's estate. Decedent's will provided that the residuary estate (which includes all LLC interests), shall be given to Trust, a non-exempt trust. You state that Trust is a Disqualified Person under § 4946. Trust's trust agreement provides that, after several specific devises and state estate taxes, the remainder of the Trust's assets, upon Decedent's death and if Husband did not survive her, will be devised to you. As noted above, Husband predeceased Decedent.

The property owned by LLC contains a private road, Road, which provides access from a state road to the office park and property owned by LLC as well as the Disqualified Persons. Road is a u-shaped, two-lane wide paved access road that contains storm sewers, sidewalks, and outdoor pole lighting. Road, which is not gated and is open to the public, provides access to some buildings owned by Disqualified Persons. The buildings owned by the Disqualified Persons are situated close to the state road so that only a small portion of Road is used by persons accessing those buildings. Most of Road is used by persons accessing buildings owned by LLC, which includes patients, clients, customers, employees, and invitees of building tenants.

The property owned by LLC also contains parking areas, which, like Road, are not gated and are open to the public. You state that buildings in the office park owned by the Disqualified Persons have adjacent parking that, generally speaking, should be sufficient for tenants and visitors to those buildings. You also state that although there is no requirement that tenants and visitors to the office park only in spaces adjacent to the building they will be visiting, the configuration of the parking areas makes it unlikely that these individuals will park in spaces other than those adjacent to their buildings.

You state that, once you receive the donation of LLC property from Trust, you and the Disqualified Persons propose to enter into separate agreements with independent third parties for maintenance and capital repairs on items such as storm sewers, sidewalks, and outdoor pole lighting on Road.

Allocations under these agreements will be based on rentable square footage in the buildings owned by each party in the office park. There will be no exchange of funds between you and the Disqualified Persons.

You represent that once you receive the donation of the LLC property (the office buildings and surrounding real property in the office park) from Trust, you will hold it for passive investment only. You also state that, because of the high vacancy rate as well as the type of office space, you anticipate you will either sell the property or enter into a § 1031 like-kind exchange transaction.

RULINGS REQUESTED

1. The continued ownership of all of the membership interests of LLC, a limited liability company, by you after you accept the donation from the Trust, will not result in "excess business holdings" under § 4943 as the membership interests in LLC do not constitute, under § 4943(d)(3)(B), a "business enterprise" because at least 95 percent of the gross income from LLC is derived from passive sources, i.e., rental income from the office park property which real property you are not actively managing.

2. The receipt by LLC as a disregarded entity (and by you as its sole member) of rental income from the office park property will not create UBTI for you under § 512(b)(3) as such rental income will be received from the leasing of real property only and the property is not debt-financed property under § 514(b)(1) as it has no acquisition indebtedness as defined under § 514(c).

3. The real property held by you through your wholly-owned limited liability company, LLC, is not "property of a kind which would properly be includible in inventory" as described in § 512(b)(5)(A) or "property held primarily for sale to customers in the ordinary course of trade or business" under § 512(b)(5)(B), and therefore income from the sale of the property is excluded from unrelated business income tax.

4. The acceptance of the donation of the membership interests in LLC by you will not constitute self-dealing under § 4941, even if Trust is a Disqualified Person under § 4946(a)(1)(G).

5. The co-location of the property owned by LLC in an office park where other office buildings and real property are owned by other entities, in which heirs of the Decedent, through intermediary limited liability companies and/or family trusts, have an ownership interest, and may also be Disqualified Persons under § 4946, does not constitute self-dealing under § 4941.

6. The access over Road and use of certain parking spaces on the office park property by Disqualified Persons and their invitees under the terms of the existing easements recorded over 45 years ago against the office park property, and the entering into of separate agreements by you and the Disqualified Persons with third parties to perform maintenance and capital repairs on Road allocated on the basis of the percentage of rentable square feet in the buildings owned by each party in the office park, do not constitute self-dealing under § 4941.

LAW

I.R.C. § 511(a) imposes a tax on the UBTI or organizations described in § 501(c). Section 511(b) imposes this unrelated business income tax on charitable trusts that are exempt from taxation under § 501(a).

I.R.C. § 512(a)(1) provides, that except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in § 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

I.R.C. § 512(b)(3)(A)(i) excludes from UBTI all rents from real property. Section 512(b)(3)(B) provides that § 512(b)(3)(A) shall not apply if (i) more than 50 percent of the total rent received or accrued under the lease is attributable to personal property described in § 512(b)(3)(A)(ii) or (ii) if the determination of the amount of such rent depends in whole or in part on the income or profits derived by any person from the property leased (other than an amount based on a fixed percentage or percentages of receipts or sales).

I.R.C. § 512(b)(4) provides that, notwithstanding paragraph (1), (2), (3), or (5), in the case of debt-financed property (as defined in § 514) there should be included, as an item of gross income derived from an unrelated trade or business, the amount ascertained under § 514(a)(1), and there should be allowed as a deduction, the amount ascertained under § 514(a)(2).

I.R.C. § 512(b)(5) excludes from UBTI all gains or losses from the sale, exchange, or other disposition of property other than –

(A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or

(B) property held primarily for sale to customers in the ordinary course of the trade or business.

I.R.C. § 513(a) provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by § 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under § 501.

I.R.C. § 514(b)(1) provides, that for purposes of this section, the term "debt-financed property" means any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c)) at any time during the taxable year.

I.R.C. § 514(c)(1) provides, that for purposes of this section, the term "acquisition indebtedness" means, with respect to any debt-financed property, the unpaid amount of –

(A) the indebtedness incurred by the organization in acquiring or improving such property;

(B) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and

(C) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

I.R.C. § 4941(a) provides for the imposition of a tax on each act of self-dealing between a Disqualified Person and a Private Foundation.

I.R.C. § 4941(d)(1) provides, in part, that the term "self-dealing" means any direct or indirect –

(A) sale or exchange, or leasing, of property between a Private Foundation and a Disqualified Person;

(B) lending of money or other extension of credit between a Private Foundation and a Disqualified Person;

(C) furnishing of goods, services, or facilities between a Private Foundation and a Disqualified Person;

(D) payment of compensation (or payment or reimbursement of expenses) by a Private Foundation to a Disqualified Person;

(E) transfer to, or use by or for the benefit of, a Disqualified Person of the income or assets of a Private Foundation.

I.R.C. § 4943 imposes excise taxes on the excess business holdings of any Private Foundation in a business enterprise.

I.R.C. § 4943(c)(1) provides that the term "excess business holdings" means, with respect to the holdings of any Private Foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a Disqualified Person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

I.R.C. § 4943(d)(3)(B) provides that the term "business enterprise" does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources. Gross income from passive sources includes the items excluded by § 512(b)(1), (2), (3), and (5).

I.R.C. § 4946(a)(1) provides that the term "Disqualified Person" means, with respect to a Private Foundation, a person who is:

(A) a substantial contributor to the foundation,

(B) a foundation manager (within the meaning of subsection (b)(1)),

(C) an owner of more than 20 percent of –

(i) the total combined voting power of a corporation,

(ii) the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,

(D) a member of the family (as defined in subsection (d)) of any individual described in subparagraph (A), (B), or (C),

(E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power,

(F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest,

(G) a trust or estate in which persons described in subparagraph (A), (B), (C), or (D) hold more than 35 percent of the beneficial interest.

Treas. Reg. § 53.4941(d)-2(f)(2) provides that the fact that a Disqualified Person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing.

ANALYSIS

Excess Business Holdings

Section 4943 imposes excise taxes on the excess business holdings of any Private Foundation in a business enterprise. Section 4943(c)(1) provides that the term "excess business holdings" means, with respect to the holdings of any Private Foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a Disqualified Person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

Section 4943(d)(3)(B) contains an exception to the excess business holdings rules and provides that the term "business enterprise " does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources. Gross income from passive sources includes the items excluded by § 512(b)(1), (2), (3), and (5). You represent that you will hold the LLC property for passive investment only and that at least 95 percent of the gross income from LLC is derived from passive sources, as described in §§ 512(b)(3) and 512(b)(5). Therefore, LLC is not a business enterprise within the meaning of § 4943(d)(3)(B) and your continued ownership of these interests will not result in excess business holdings.

Unrelated Business Income Tax

Section 511(a) imposes a tax on the UBTI or organizations described in § 501(c). Section 511(b) imposes this unrelated business income tax on charitable trusts that are exempt from taxation under § 501(a). Section 512(a)(1) provides, that except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in § 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Section 513(a) provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by § 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under § 501.

Under § 513(a), your ownership and operation of LLC would constitute an "unrelated trade or business" as such activity is a trade or business not substantially related to your charitable purposes of distributing funds to appropriate organizations. However, with respect to the rents you receive from the rental of LLC office space, you meet an exclusion to the UBTI provisions.

Section 512(b)(3)

Section 512(b)(3)(A)(i) excludes from UBTI all rents from real property. Section 512(b)(3)(B) provides that § 512(b)(3)(A) shall not apply if (i) more than 50 percent of the total rent received or accrued under the lease is attributable to personal property described in § 512(b)(3)(A)(ii) or (ii) if the determination of the amount of such rent depends in whole or in part on the income or profits derived by any person from the property leased (other than an amount based on a fixed percentage or percentages of receipts or sales). You represent that the rental income you will receive is not attributable to personal property and is not determined based on the income or profits derived by any person from the property leased. Therefore, neither of the § 512(b)(3)(B) exceptions to the § 512(b)(3)(A) exclusion apply here.

There is also another exception to the exclusion for rents from real property under § 512(b)(3). Section 512(b)(4) provides that, notwithstanding paragraph (1), (2), (3), or (5), in the case of debt-financed property (as defined in § 514) there should be included, as an item of gross income derived from an unrelated trade or business, the amount ascertained under § 514(a)(1), and there should be allowed as a deduction, the amount ascertained under § 514(a)(2).

Section 514(b)(1) provides, that for purposes of this section, the term "debt-financed property" means any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c)) at any time during the taxable year. Section 514(c)(1) provides, that for purposes of this section, the term "acquisition indebtedness" means, with respect to any debt-financed property, the unpaid amount of -- (A) the indebtedness incurred by the organization in acquiring or improving such property; (B) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and (C) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

You represent that rental income received by LLC is not from any debt-financed property under § 512(b)(4) as there is no acquisition indebtedness relating to LLC property nor do you ever contemplate incurring acquisition indebtedness for acquisition or improvement of LLC property. Therefore, because you meet the requirements of § 512(b)(3)(A) and no exceptions to this exclusion are applicable, the receipt by LLC as a disregarded entity (and by you as its sole member) of rental income from LLC property will not create UBTI for you under § 512(b)(3).

Section 512(b)(5)

Section 512(b)(5) excludes from UBTI all gains or losses from the sale, exchange, or other disposition of property other than -- (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business.

You state that you anticipate selling or exchanging the LLC property to a third party. You represent that you does not currently have an inventory of real property you own and that you do not intend to acquire real properties and hold them for sale or lease to others. You also represent that the LLC property, once it is transferred from the Trust to you, will be the only real property that you directly own. Based on these representations, you meet the requirements of § 512(b)(5) and the real property held by you through LLC will be excluded from UBTI as is not "property of a kind which would properly be includible in inventory" as described in § 512(b)(5)(A) or "property held primarily for sale to customers in the ordinary course of trade or business" under § 512(b)(5)(B).

Self-Dealing Donation of LLC Interests to You

Section 4941(a) provides for the imposition of a tax on each act of self-dealing between a Disqualified Person and a Private Foundation. Section 4941(d)(1)(A) provides that the term "self dealing" means any direct or indirect sale or exchange, or leasing, of property between a Private Foundation and a Disqualified Person. You state that the LLC interests will be donated from Decedent's estate to you through Trust and that Trust is a Disqualified Person as described in § 4946(a)(1)(G). You represent that the donation of the LLC membership interests from Trust to you is without consideration paid or liability assumed. There is no prohibition against a Disqualified Person making a donation or contribution to a Private Foundation if there is no obligation, lien, debt or any restriction and it is an outright gift. Therefore, because there is no sale, exchange, or leasing of property between you and Trust, the acceptance of the donation of the LLC membership interests without restrictions or any obligations on your part will not constitute self-dealing under § 4941.

Co-location of Property

Section 4941(d)(1)(E) provides that the term "self-dealing" means any direct or indirect transfer to, or use by or for the benefit of, a Disqualified Person of the income or assets of a Private Foundation. Section 53.4941(d)-2(f)(2) provides that the fact that a Disqualified Person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing. You state that once you receive the LLC membership interests, you will own property that is located in the same office park as property owned by Disqualified Persons, within the meaning of § 4946, through various limited liability companies and trusts.

You state that you will be receiving the LLC interests pursuant to a bequest from Decedent. Therefore, the location of the LLC property you will receive next to that of the Disqualified Persons is not of your choosing. In addition, as noted above, you anticipate selling or exchanging the property and, consequently, you will not be holding it long term. Based on these facts and circumstances, any benefit the Disqualified Persons may receive from the co-location of property next to yours is incidental or tenuous within the meaning of § 53.4941(d)-2(f)(2). Therefore, the co-location of LLC property next to property owned by Disqualified Persons will not constitute self-dealing under § 4941.

Use of Road and Parking and Road Maintenance

Absent an exception, § 4941(d)(1)(E) would apply to the use of LLC's Road and parking for the benefit of visitors to the property of the Disqualified Persons. This use of Road and parking is pursuant to a pre-existing, more than 45 year old easement that was recorded prior to the development of the office park and before your formation and the existence of any Disqualified Persons. You represent that, based on the configuration of the office park, visitors use Road to access only some of the buildings owned by the Disqualified Persons and only use a very small portion of Road. You state that these visitors are predominately compensated of members of the general public, including patients, clients, customers, employees, and invitees of building tenants. You represent that most of Road is used by those accessing LLC's property.

Buildings owned by Disqualified Persons also have an easement for the use of parking areas surrounding LLC buildings to be received by you. This is part of the same easement discussed above granted over 45 years prior to the transaction proposed in this ruling request. Further, each building owned by a Disqualified Person is immediately surrounded by its own land improved by parking areas or parking lots. Generally speaking, the Disqualified Person-owned parking areas adjacent to Disqualified Person owned buildings should be sufficient for the needs of customers and tenants making use of the Disqualified Person owned buildings. You also state that although there is no requirement that tenants and visitors to the office park only in spaces adjacent to the building they will be visiting, the configuration of the parking areas makes it unlikely that these individuals will park in spaces other than those adjacent to their buildings. Therefore, based on your representations, it is rare that visitors to buildings owned by Disqualified Persons will park in areas owned by LLC.

In addition, as noted earlier, the location of the LLC property you will receive next to that of the Disqualified Persons is not of your choosing and you anticipate selling or exchanging the property. Therefore, the use of Road and parking will not be long-term. Based on these facts and circumstances, any benefit the Disqualified Persons may receive from Road access or the use of certain parking spaces is incidental or tenuous within the meaning of § 53.4941(d)-2(f)(2) and will therefore not constitute self-dealing under § 4941.

Further, the right of customers of the Disqualified Person-owned buildings to use Road and the parking areas is of such a long-standing nature, that the Disqualified Person use does not constitute use of Private Foundation property or assets in that the easement sanctions the use by customers of the Disqualified Persons. You have submitted documentation with your ruling request that supports the long-standing nature of this arrangement and that it was arranged prior to the involved parties being defined as Disqualified Persons and there was obviously no intent to avoid the rules of Chapter 42. Thus, the Disqualified Person use does not come within the parameters of § 4941(d)(1)(E) under the facts of this particular case.

Finally, you represent that you and the Disqualified Persons propose to enter into separate agreements, based on rentable square footage owned in the office park, with third parties to perform maintenance and capital repairs of Road. Because these agreements are with independent third parties, and do not involve a transaction between you and Disqualified Persons, they do not constitute self-dealing under § 4941.

RULINGS

Based on the information and representations submitted, we rule as follows:

1. The continued ownership of all of the membership interests of LLC, by you after you accept the donation from Trust, will not result in excess business holdings under § 4943 as the membership interests in LLC do not constitute, under § 4943(d)(3)(B), a business enterprise because at least 95 percent of the gross income from is derived from passive sources, i.e. rental income from the office park property which real property you are not actively managing.

2. The receipt by LLC as a disregarded entity (and by you as its sole member) of rental income from the office park property will not create UBTI for you under § 512(b)(3) as such rental income will be received from the leasing of real property only and the property is not debt-financed property under § 514(b)(1) as it has no acquisition indebtedness as defined under § 514(c).

3. The real property held by you through your wholly-owned limited liability company, LLC, is not "property of a kind which would properly be includible in inventory" as described in § 512(b)(5)(A) or "property held primarily for sale to customers in the ordinary course of trade or business" under § 512(b)(5)(B), and therefore income from the sale of the property is excluded from unrelated business income tax.

4. The acceptance of the donation of the membership interests in LLC by you will not constitute self-dealing under § 4941, even if Trust is a Disqualified Person under § 4946(a)(1)(G).

5. The co-location of the property owned by LLC in an office park where other office buildings and real property are owned by other entities, in which heirs of the Decedent,

through intermediary limited liability companies and/or family trusts, have an ownership interest, and may also be Disqualified Persons under § 4946, does not constitute self-dealing under § 4941.

6. The access over Road and use of certain parking spaces on the office park property by Disqualified Persons and their invitees under the terms of existing easements recorded over 45 years ago against the office park property, and the entering into of separate agreements by you and the Disqualified Persons with third parties to perform maintenance and capital repairs on Road allocated on the basis of the percentage of rentable square feet in the buildings owned by each party in the office park, do not constitute self-dealing under § 4941.

This ruling will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. § 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

<u>EXHIBIT B:</u>
IRS FORM 1023, APPLICATION FOR RECOGNITION OF EXEMPTION UNDER SECTION 501(C)(3)

Form **1023** (Rev. January 2020) Department of the Treasury Internal Revenue Service	**Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code** Do not enter social security numbers on this form as it may be made public. Go to www.irs.gov/Form1023 for instructions and the latest information.	OMB No. 1545-0047 **Note:** *If exempt status is approved, this application will be open for public inspection.*

Use the "?" buttons throughout this form for help in completing this application. For additional help, call IRS Exempt Organizations Customer Account Services toll-free at 1-877-829-5500.

If you cannot complete required responses within the textbox limits throughout this form, upload your additional narratives with the other required documents.

Part I Identification of Applicant

1a Full Name of Organization (exactly as it appears in your organizing document)		b Care of Name (if applicable)	
c Mailing Address (Number, street and room/suite)	d City	e Country	
f State	g Zip Code + 4	h Foreign Province (or State)	i Foreign Postal Code
2 Employer Identification Number	3 Month Tax Year Ends	4 Person to Contact if More Information is Needed (officer, director, trustee, or authorized representative)	
5 Contact Telephone Number	6 Fax Number (optional)	7 User Fee Submitted	

8 Organization's Website (if available):

9 List the names, titles, and mailing addresses of your officers, directors, and/or trustees.

First Name:	Last Name:	Title:
Mailing Address:	City:	
State (or Province):	Zip Code (or Foreign Postal Code):	
First Name:	Last Name:	Title:
Mailing Address:	City:	
State (or Province):	Zip Code (or Foreign Postal Code):	
First Name:	Last Name:	Title:
Mailing Address:	City:	
State (or Province):	Zip Code (or Foreign Postal Code):	
First Name:	Last Name:	Title:
Mailing Address:	City:	
State (or Province):	Zip Code (or Foreign Postal Code):	
First Name:	Last Name:	Title:
Mailing Address:	City:	
State (or Province):	Zip Code (or Foreign Postal Code):	

☐ Check here to add more officers, directors, and/or trustees.

For Paperwork Reduction Act Notice, see instructions. Cat. No. 17133K Form **1023** (Rev. 01-2020)

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Part II Organizational Structure

1 You must be a corporation, limited liability company (LLC), unincorporated association, or trust to be tax exempt.

Select your type of organization.

◯ Corporation

At the end of this form, you must upload a copy of your articles of incorporation (and any amendments) that shows proof of filing with the appropriate state agency.

◯ Limited Liability Company (LLC)

At the end of this form, you must upload a copy of your articles of organization (and any amendments) that shows proof of filing with the appropriate state agency. Also, if you adopted an operating agreement, upload a copy, along with any amendments.

◯ Unincorporated Association

At the end of this form, you must upload a copy of your articles of association, constitution, or other similar organizing document that is dated and includes at least two signatures. Include signed and dated copies of any amendments.

◯ Trust

At the end of this form, you must upload a signed and dated copy of your trust agreement. Include signed and dated copies of any amendments.

2 Enter the date you formed. (MM/DD/YYYY)

3 Select your state (or U.S. territory) of incorporation or other formation. If you were formed under the laws of a foreign country, select Foreign Country.

4 Have you adopted bylaws? If "Yes," at the end of this form, upload a current copy showing the date of adoption. If "No," explain how you select your officers, directors, or trustees. ◯ Yes ◯ No

5 Are you a successor to another organization? ◯ Yes ◯ No

Answer "Yes" if you have taken or will take over the activities of another organization, you took over 25% or more of the fair market value of the net assets of another organization, or you were established upon the conversion of an organization from for-profit to nonprofit status. If "Yes," complete Schedule G.

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Part III **Required Provisions in Your Organizing Document**

Part III helps ensure that, when you submit this application, your organizing document contains the required provisions to meet the organizational test under section 501(c)(3).

If you cannot check "Yes" in both Lines 1 and 2, your organizing document does not meet the organizational test. DO NOT file this application until you have amended your organizing document. Remember to upload your original and amended organizing documents at the end of this form.

1 Section 501(c)(3) requires that your organizing document limit your purposes to one or more exempt purposes within section 501(c)(3), such as charitable, religious, educational, and/or scientific purposes.

The following is an example of an acceptable purpose clause: The organization is organized exclusively for charitable, religious, educational, and scientific purposes under section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code.

Does your organizing document meet this requirement? ◯ Yes ◯ No

1a State specifically where your organizing document meets this requirement, such as a reference to a particular article or section in your organizing document (Page/Article/Paragraph):

2 Section 501(c)(3) requires that your organizing document provide that upon dissolution, your remaining assets be used exclusively for section 501(c)(3) exempt purposes, such as charitable, religious, educational, and/or scientific purposes. Depending on your entity type and the state in which you are formed, this requirement may be satisfied by operation of state law.

The following is an example of an acceptable dissolution clause: Upon the dissolution of this organization, assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government, for a public purpose.

Does your organizing document meet this requirement? ◯ Yes ◯ No

2a State specifically where your organizing document meets this requirement, such as a reference to a particular article or section in your organizing document (Page/Article/Paragraph) or indicate that you rely on state law.

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Part IV Your Activities

1 **Describe completely and in detail your past, present, and planned activities. Do not refer to or repeat the purposes in your organizing document.**
For each past, present, or planned activity, include information that answers the following questions:

a. **What is the activity?**
b. **Who conducts the activity?**
c. **Where is the activity conducted?**
d. **What percentage of your total time is allocated to the activity?**
e. **How is the activity funded (for example, donations, fees, etc.) and what percentage of your overall expenses is allocated to this activity?**
f. **How does the activity further your exempt purposes?**

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Part IV **Your Activities** *(continued)*

2 Enter the 3-character NTEE Code that best describes your activities.

Or check here if you want the IRS to select the NTEE Code that best describes your activities.

3 Do any of your programs limit the provision of goods, services, or funds to a specific individual or group of specific individuals? For example, answer "Yes" if goods, services, or funds are provided only for a particular individual, your members, individuals who work for a particular employer, or graduates of a particular school. If "Yes," explain the limitation and how recipients are selected for each program. Yes No

4 Do any individuals who receive goods, services, or funds through your programs have a family or business relationship with any officer, director, trustee, or with any of your highest compensated employees or highest compensated independent contractors? If "Yes," explain how these related individuals are eligible for goods, services, or funds. Yes No

5 Do you or will you support or oppose candidates in political campaigns in any way? If "Yes," explain. Yes No

6 Do you or will you attempt to influence legislation? If "Yes," explain how you attempt to influence legislation. Yes No

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Part IV **Your Activities** *(continued)*

6a Did you or will you make an election to have your legislative activities measured by expenditures by filing Form 5768? If "No," describe whether your attempts to influence legislation are a substantial part of your activities. Include the time and money spent on your attempts to influence legislation as compared to your total activities. ◯ Yes ◯ No

7 Do you or will you publish, own, or have rights in music, literature, tapes, artworks, choreography, scientific discoveries, or other intellectual property? If "Yes," describe who owns or will own any copyrights, patents, or trademarks, whether fees are or will be charged, how the fees are determined, and how any items are or will be produced, distributed, and marketed. ◯ Yes ◯ No

8 Do you or will you provide educational information to the general public on budgeting, personal finance, financial literacy, saving and spending practices, the sound use of consumer credit, and/or assist individuals and families with financial problems such as credit card debt and foreclosure by providing them with counseling? If "Yes," explain. ◯ Yes ◯ No

9 Do you or will you make grants, loans, or other distributions to organizations? If "Yes," describe the type and purpose of the grants, loans, or distributions, how you select your recipients including submission requirements (such as grant proposals or application forms), and the criteria you use or will use to select recipients. Also describe how you ensure the grants, loans, and other distributions are or will be used for their intended purposes (including whether you require periodic or final reports on the use of funds and any procedures you have if you identify that funds are not being used for their intended purposes). Finally, describe the records you keep with respect to grants, loans, or other distributions you make and identify any recipient organizations and any relationships between you and the recipients. If "No," continue to Line 10. ◯ Yes ◯ No

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Part IV **Your Activities** *(continued)*

9a Do you or will you make grants, loans, or other distributions to organizations that are not recognized by the IRS as tax exempt under section 501(c)(3)? If "Yes," name and/or describe the non-section 501(c)(3) organizations to whom you do or will make distributions and explain how these distributions further your exempt purposes. ◯ Yes ◯ No

9b Do you or will you make grants, loans, or other distributions to foreign organizations? If "Yes," name each foreign organization (if not already provided), the country and region within each country in which each foreign organization operates, any relationship you have with each foreign organization, and whether the foreign organization accepts contributions earmarked for a specific country or organization (if so, specify which countries or organizations). If "No," continue to Line 10. ◯ Yes ◯ No

9c Do your contributors know that you have ultimate authority to use contributions made to you at your discretion for purposes consistent with your exempt purposes? If "Yes," describe how you relay this information to contributors. ◯ Yes ◯ No

9d Do you or will you make pre-grant inquiries about the recipient organization? If "Yes," describe these inquiries, including whether you inquire about the recipient's financial status, its tax-exempt status under the Internal Revenue Code, its ability to accomplish the purpose for which the resources are provided, and other relevant information. ◯ Yes ◯ No

9e Do you or will you use any additional procedures to ensure that your distributions to foreign organizations are used in furtherance of your exempt purposes? If "Yes," describe these procedures, including periodic reporting requirements, auditing grantees, site visits by your employees or compliance checks by impartial experts, etc., to verify that grant funds are being used appropriately. ◯ Yes ◯ No

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Part IV **Your Activities** *(continued)*

9f Do you share board members or other key personnel with the recipient organization(s)? If "Yes," identify the relationships. ◯ Yes ◯ No

9g When you make grants, loans, or other distributions to foreign organizations, will you check the OFAC List of Specially Designated Nationals and Blocked Persons for names of individuals and entities with whom you are dealing to determine if they are included on the list? Describe any other practices you will engage in to ensure that foreign expenditures or grants are not diverted to support terrorism or other non-charitable activities. ◯ Yes ◯ No

9h Will you comply with all United States statutes, executive orders, and regulations that restrict or prohibit U.S. persons from engaging in transactions and dealings with designated countries, entities, or individuals, or otherwise engaging in activities in violation of economic sanctions administered by OFAC? ◯ Yes ◯ No

9i Will you acquire from OFAC the appropriate license and registration where necessary? ◯ Yes ◯ No

10 Do you or will you operate in a foreign country or countries? If "Yes," name each foreign country and region within each country in which you do or will operate and describe your operations in each one. If "No," continue to Line 11. ◯ Yes ◯ No

10a When you conduct activities in foreign countries, will you check the OFAC List of Specially Designated Nationals and Blocked Persons for names of individuals and entities with whom you are dealing to determine if they are included on the list? Describe any other practices you will engage in to ensure that foreign expenditures or grants are not diverted to support terrorism or other non-charitable activities. ◯ Yes ◯ No

10b Will you comply with all United States statutes, executive orders, and regulations that restrict or prohibit U.S. persons from engaging in transactions and dealings with designated countries, entities, or individuals, or otherwise engaging in activities in violation of economic sanctions administered by OFAC? ◯ Yes ◯ No

10c Will you acquire from OFAC the appropriate license and registration where necessary? ◯ Yes ◯ No

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Part IV **Your Activities** *(continued)*

11 Are you a sponsoring organization that maintains one or more donor advised funds? If yes, please provide a complete description of your program, including the specific advice that such donors may provide. Describe in detail the control you maintain (or will maintain) over the use of the funds. ◯ Yes ◯ No

12 Do you or will you operate a school?
If "Yes," complete Schedule B. ◯ Yes ◯ No

13 Is your principal purpose or function to provide hospital or medical care?
If "Yes," complete Schedule C. ◯ Yes ◯ No

14 Do you or will you provide low-income housing?
If "Yes," complete Schedule F. ◯ Yes ◯ No

15 Do you or will you provide scholarships, fellowships, educational loans, or other educational grants to individuals, including grants for travel, study, or other similar purposes?
If "Yes," complete Schedule H - Section I. ◯ Yes ◯ No

16 Check any of the following fundraising activities that you will undertake (check all that apply):

- ☐ Website, mail, email, personal, and/or phone solicitations
- ☐ Foundation grant solicitations
- ☐ Receive donations from another organization's website
- ☐ Government grant solicitations
- ☐ Bingo
- ☐ Other (non-bingo) gaming activities
- ☐ Other (describe)
- ☐ We will not engage in fundraising activities.

17 Do you or will you engage in fundraising activities for other organizations? If "Yes," describe these arrangements, including the names or descriptions of the organizations for which you raise funds. ◯ Yes ◯ No

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Part V **Compensation and Other Financial Arrangements**

1 Do you or will you compensate officers, directors, or trustees, or do or will you have highest compensated employees, or highest compensated independent contractors? If "No," continue to Line 2. ◯ Yes ◯ No

In establishing compensation for your officers, directors, trustees, highest compensated employees, and highest compensated independent contractors:

1a Do or will the individuals that approve compensation arrangements follow a conflict of interest policy? ◯ Yes ◯ No

1b Do or will you approve compensation arrangements in advance of paying compensation? ◯ Yes ◯ No

1c Do or will you document in writing the date and terms of approved compensation arrangements? ◯ Yes ◯ No

1d Do or will you record in writing the decision made by each individual who decided or voted on compensation arrangements? ◯ Yes ◯ No

1e Do or will you approve compensation arrangements based on information about compensation paid by similarly situated taxable or tax-exempt organizations for similar services, current compensation surveys compiled by independent firms, or actual written offers from similarly situated organizations? ◯ Yes ◯ No

1f Do or will you record in writing both the information on which you relied to base your decision and its source? ◯ Yes ◯ No

1g Do or will you have any other practices you use to set reasonable compensation? If "Yes," describe these practices. ◯ Yes ◯ No

2 Have you adopted a conflict of interest policy consistent with the sample conflict of interest policy in Appendix A to the instructions? If you are a hospital, answer "Yes" if your conflict of interest policy includes provisions consistent with the additional healthcare related provisions in the sample document. If "No," describe the procedures you will follow to ensure that persons who have a conflict of interest will not have influence over setting their own compensation or regarding business deals with themselves. ◯ Yes ◯ No

3 Do you or will you compensate any of your officers, directors, trustees, highest compensated employees, and highest compensated independent contractors through non-fixed payments, such as discretionary bonuses or revenue-based payments? If "Yes," describe all non-fixed compensation arrangements, including how the amounts are determined, who is eligible for such arrangements, whether you place a limitation on total compensation, and how you determine or will determine that you pay no more than reasonable compensation for services. ◯ Yes ◯ No

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Part V **Compensation and Other Financial Arrangements** *(continued)*

4 Do you or will you purchase or sell any goods, services, or assets from or to: (i) any of your officers, directors, or trustees; (ii) any family of any of your officers, directors, or trustees; (iii) any organizations in which any of your officers, directors, or trustees are also officers, directors, or trustees, or in which any individual officer, director, or trustee owns more than a 35% interest; (iv) your highest compensated employees; or (v) your highest compensated independent contractors? If "Yes," describe any such transactions that you made or intend to make, with whom you make or will make such transactions, how the terms are or will be negotiated at arm's length, and how you determine you pay no more than fair market value or you are paid at least fair market value. ◯ Yes ◯ No

5 Do you or will you have any leases, contracts, loans, or other agreements with: (i) your officers, directors, or trustees; (ii) any family of any of your officers, directors, or trustees; (iii) any organizations in which any of your officers, directors, or trustees are also officers, directors, or trustees, or in which any individual officer, director, or trustee owns more than a 35% interest; (iv) your highest compensated employees; or (v) your highest compensated independent contractors? If "Yes," describe any written or oral arrangements that you made or intend to make, with whom you have or will have such arrangements, how the terms are or will be negotiated at arm's length, and how you determine you pay no more than fair market value or you are paid at least fair market value. ◯ Yes ◯ No

6 Do you or will you contract with another organization to develop, build, market, or finance your facilities? If "Yes," describe each facility, the role of the other organization, and any business or family relationship between the organization and your officers, directors, or trustees. Explain how that entity is selected, how the terms of any contract(s) are negotiated at arm's length, and how you determine you will pay no more than fair market value for services. ◯ Yes ◯ No

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Part V **Compensation and Other Financial Arrangements** *(continued)*

7 Does or will someone other than your own employees or volunteers manage your activities or facilities? ◯ Yes ◯ No
If "Yes," describe the activities or facilities that will be managed by others, the names of the persons or organizations that manage or will manage your activities or facilities, and any business or family relationship between the organization and your officers, directors, or trustees. Explain how these managers were or will be selected, how the terms of any contracts or other agreements were or will be negotiated, and how you determine you will pay no more than fair market value for services.

8 Do you participate in any joint ventures, including partnerships or limited liability companies treated as partnerships, in which you share profits and losses with partners? If "Yes," state your ownership percentage in each joint venture, list your investment in each joint venture, describe the tax status of other participants in each joint venture (including whether they are section 501(c)(3) organizations), describe the activities of each joint venture, describe how you exercise control over the activities of each joint venture, and describe how each joint venture furthers your exempt purposes. ◯ Yes ◯ No

Part VI **Financial Data**

1 Select the option that best describes you to determine the years of revenues and expenses you need to provide.

◯ You completed less than one tax year.
Provide a total of three years of financial information (including the current year and two future years of reasonable and good faith projections of your future finances) in the following Statement of Revenues and Expenses.

◯ You completed at least one tax year but fewer than five.
Provide a total of four years financial information (including the current year and three years of actual financial information or reasonable and good faith projections of your future finances) in the following Statement of Revenues and Expenses.

◯ You completed five or more tax years.
Provide financial information for your five most recent tax years (including the current year) in the following Statement of Revenues and Expenses.

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Part VI **Financial Data** *(continued)*

A. Statement of Revenues and Expenses						
	Type of revenue	**Current tax year**	**4 prior tax years or 2 succeeding tax years**			
		From: __/__/____ To: __/__/____	From: __/__/____ To: __/__/____	From: __/__/____ To: __/__/____	From: __/__/____ To: __/__/____	From: __/__/____ To: __/__/____
1	Gifts, grants, and contributions received (do not include unusual grants)					
2	Membership fees received					
3	Gross investment income					
4	Net unrelated business income					
5	Taxes levied for your benefit					
6	Value of services or facilities furnished by a governmental unit without charge (not including the value of services generally furnished to the public without charge)					
7	Any revenue not otherwise listed above or in lines 9 - 12 below (provide an itemized list below)					
8	Total of lines 1 through 7					
9	Gross receipts from admissions, merchandise sold or services performed, or furnishing of facilities in any activity that is related to your exempt purposes (provide an itemized list below)					
10	Total of lines 8 and 9					
11	Net gain or loss on sale of capital assets (provide an itemized list below)					
12	Unusual grants (provide an itemized list below)					
13	Total Revenue (add lines 10 through 12)					
	Type of expense	**Current tax year**	**4 prior tax years or 2 succeeding tax years**			
14	Fundraising expenses					
15	Contributions, gifts, grants, and similar amounts paid out (provide an itemized list below)					
16	Disbursements to or for the benefit of members (provide an itemized list below)					
17	Compensation of officers, directors, and trustees					
18	Other salaries and wages					
19	Interest expense					
20	Occupancy (rent, utilities, etc.)					
21	Depreciation and depletion					
22	Professional fees					
23	Any expense not otherwise classified, such as program services (provide an itemized list below)					
24	Total Expenses (add lines 14 through 23)					

25 Itemized financial data

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Part VI **Financial Data** *(continued)*

B. Balance Sheet (for your most recently completed tax year)	Year End:
Assets	
1 Cash	
2 Accounts receivable, net	
3 Inventories	
4 Bonds and notes receivable (provide an itemized list below)	
5 Corporate stocks (provide an itemized list below)	
6 Loans receivable (provide an itemized list below)	
7 Other investments (provide an itemized list below)	
8 Depreciable assets (provide an itemized list below)	
9 Land	
10 Other assets (provide an itemized list below)	
11 Total Assets (add lines 1 through 10)	
Liabilities	
12 Accounts payable	
13 Contributions, gifts, grants, etc. payable	
14 Mortgages and notes payable (provide an itemized list below)	
15 Other liabilities (provide an itemized list below)	
16 Total Liabilities (add lines 12 through 15)	
Fund Balances or Net Assets	
17 Total fund balances or net assets	
18 Total Liabilities and Fund Balances or Net Assets (add lines 16 and 17)	

19 Itemized financial data

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Part VII **Foundation Classification**

Part VII is designed to classify you as an organization that is either a private foundation or a public charity. Public charity classification is a more favorable tax status than private foundation classification. If you are a private foundation, this part will further determine whether you are a private operating foundation.

1 Select the foundation classification you are requesting from the list below.

- ☐ You are described in 509(a)(1) and 170(b)(1)(A)(vi) as an organization that receives a substantial part of its financial support in the form of contributions from publicly supported organizations, from a governmental unit, or from the general public.
- ☐ You are described in 509(a)(2) as an organization that normally receives not more than one-third of its financial support from gross investment income and receives more than one-third of its financial support from contributions, membership fees, and gross receipts from activities related to its exempt functions (subject to certain exceptions).
- ☐ You are described in 509(a)(1) and 170(b)(1)(A)(i) as a church or a convention or association of churches. Complete Schedule A.
- ☐ You are described in 509(a)(1) and 170(b)(1)(A)(ii) as a school. Complete Schedule B.
- ☐ You are described in 509(a)(1) and 170(b)(1)(A)(iii) as a hospital, a cooperative hospital service organization, or a medical research organization operated in conjunction with a hospital. Complete Schedule C.
- ☐ You are described in 509(a)(1) and 170(b)(1)(A)(iv) as an organization operated for the benefit of a college or university that is owned or operated by a governmental unit.
- ☐ You are described in 509(a)(1) and 170(b)(1)(A)(ix) as an agricultural research organization directly engaged in the continuous active conduct of agricultural research in conjunction with a college or university.
- ☐ You are described in 509(a)(3) as an organization supporting either one or more organizations described in 509(a)(1) or 509(a)(2) or a publicly supported section 501(c)(4), (5), or (6) organization. Complete Schedule D.
- ☐ You are described in 509(a)(4) as an organization organized and operated exclusively for testing for public safety.
- ☐ You are a publicly supported organization and would like the IRS to decide your correct classification.
- ☐ You are a private foundation.

1a As a private foundation, section 508(e) requires special provisions in your organizing document in addition to those that apply to all organizations described in section 501(c)(3). Check this box to confirm that your organizing document includes these provisions or you rely on state law. ☐

State specifically where your organizing document meets this requirement, such as a reference to a particular article or section in your organizing document (Page/Article/Paragraph) or state that you rely on state law.

1b Do you or will you provide scholarships, fellowships, educational loans, or other educational grants to individuals, including grants for travel, study, or other similar purposes? ◯ Yes ◯ No
If "Yes," complete Schedule H - Section II.

1c Are you a private operating foundation? ◯ Yes ◯ No

To be a private operating foundation you must engage directly in the active conduct of charitable, religious, educational, and similar activities, as opposed to indirectly carrying out these activities by providing grants to individuals or other organizations.

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Part VII **Foundation Classification** *(continued)*

1d Describe how you meet the requirements for private operating foundation status, including how you meet the income test and either the assets test, the endowment test, or the support test. If you've been in existence for less than one year, describe how you are likely to satisfy the requirements for private operating foundation status.

2 If you have been in existence more than 5 years, you must confirm your public support status. To confirm your qualification as a public charity described in 509(a)(1) and 170(b)(1)(A)(vi) in existence for five or more tax years, you must have received one-third or more of your total support from governmental agencies, contributions from the general public, and contributions or grants from other public charities; or 10% or more of your total support from governmental agencies, contributions from the general public, and contributions or grants from other public charities and the facts and circumstances indicate you are a publicly supported organization. Calculate whether you meet this support test for your most recent five-year period.

i. Did you receive contributions from any person, company, or organization whose gifts totaled more than the 2% amount of line 8 in Part VI-A? ◯ Yes ◯ No

If "Yes," identify each person, company, or organization by letter (A, B, C, etc.) and indicate the amount contributed by each. Keep a list showing the name of and amount contributed by each of these donors for your records.

ii. Based on your calculations, did you receive at least one-third of your support from public sources or did you normally receive at least 10 percent of your support from public sources and you have other characteristics of a publicly supported organization? ◯ Yes ◯ No

2a If you have been in existence more than 5 years, you must confirm your public support status. To confirm your qualification as a public charity described in 509(a)(2) in existence for five or more tax years, you must have normally received more than one-third of your support from contributions, membership fees, and gross receipts from activities related to your exempt functions, or a combination of these sources, and not more than one-third of your support from gross investment income and net unrelated business income. Calculate whether you meet this support test for your most recent five-year period.

i. Did you receive amounts from any disqualified persons? ◯ Yes ◯ No

If "Yes," identify each disqualified person by letter (A, B, C, etc.) and indicate the amount contributed by each. Keep a list showing the name of and amount contributed by each of these donors for your records.

ii. Did you receive amounts from individuals or organizations other than disqualified persons that exceeded the greater of $5,000 or 1% of the amount on line 10 of Part VI-A Statement of Revenues and Expenses? ◯ Yes ◯ No

If "Yes," identify each individual or organization by letter (A, B, C, etc.) and indicate the amount contributed by each. Keep a list showing the name of and amount contributed by each of these donors for your records.

iii. Based on your calculations, did you normally receive more than one-third of your support from a combination of gifts, grants, contributions, membership fees, and gross receipts (from permitted sources) from activities related to your exempt functions and normally receive not more than one-third of your support from investment income and unrelated business taxable income? ◯ Yes ◯ No

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Part VIII Effective Date

In general, a determination letter recognizing exemption of an organization described in section 501(c)(3) is effective as of the date of formation of an organization if: (1) its purposes and activities prior to the date of the determination letter have been consistent with the requirements for exemption; and (2) it has filed an application for recognition of exemption within 27 months from the end of the month in which it was organized.

1 Are you submitting this application within 27 months of the end of the month in which you were legally formed? ☐ Yes ☐ No

If "No," complete Schedule E.

Part IX Annual Filing Requirements

If you fail to file a required information return or notice for three consecutive years, your exempt status will be automatically revoked.

1 Certain organizations are not required to file annual information returns or notices (Form 990, Form 990-EZ, or Form 990-N, e-Postcard). If you are granted tax-exemption, are you claiming to be excused from filing Form 990, Form 990-EZ, or Form 990-N? ☐ Yes ☐ No

If "Yes," are you claiming you are excepted from filing because you are:

☐ A church or association of churches

☐ An integrated auxiliary (such as a men's or women's organization, religious school, mission society, or religious group)

☐ A church-affiliated organization (other than a section 509(a)(3) organization) that is exclusively engaged in managing funds or maintaining retirement programs and is described in Revenue Procedure 96-10, 1996-1 C.B. 577

☐ A school below college level affiliated with a church or operated by a religious order

☐ A mission society (other than a section 509(a)(3) supporting organization) sponsored by, or affiliated with, one or more churches or church denominations, if more than half of the society's activities are conducted in, or directed at, persons in foreign countries

☐ An affiliate of a governmental unit that meets the requirements of Revenue Procedure 95-48, 1995-2 C.B. 418 (other than a section 509(a)(3) supporting organization)

☐ Other (describe)

Part X Signature

☐ I declare under the penalties of perjury that I am authorized to sign this application on behalf of the above organization and that I have examined this application, and to the best of my knowledge it is true, correct, and complete.

(Type name of signer) (Type title or authority of signer)

(Date)

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Upload checklist:

- ☐ Organizing document (and any amendments)
- ☐ Bylaws, if adopted
- ☐ Form 2848, Power of Attorney and Declaration of Representative (if applicable)
- ☐ Form 8821, Tax Information Authorization (if applicable)
- ☐ Supplemental responses (if applicable)
- ☐ Expedited handling request (if applicable)

Schedule A. Churches

1	**Do you have a written creed, statement of faith, or summary of beliefs? If "Yes," describe your written creed, statement of faith, or summary of beliefs.**	◯ **Yes** ◯ **No**
2	**Do you have a literature of your own? If "Yes," describe your literature.**	◯ **Yes** ◯ **No**
3	**Do you have a formal code of doctrine and discipline? If "Yes," describe your code of doctrine and discipline.**	◯ **Yes** ◯ **No**
4	**Describe your religious hierarchy or ecclesiastical government.**	
5	**Are you part of a group of churches with similar beliefs and structures? If "Yes," explain.**	◯ **Yes** ◯ **No**
6	**Do you have a form of worship? If "Yes," describe your form of worship.**	◯ **Yes** ◯ **No**
7	**Do you have regularly scheduled religious services? If "Yes," describe the nature of the services.**	◯ **Yes** ◯ **No**
7a	**What is the average attendance at your regularly scheduled religious services?**	
8	**Do you have an established place of worship? If "Yes," describe your established place of worship or where you meet to hold regularly scheduled religious services.**	◯ **Yes** ◯ **No**

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Schedule A. Churches *(continued)*

9	Do you have an established congregation or other regular membership group? If "No," continue to Line 10.	Yes	No
9a	How many members do you have?		
9b	Do you have a process by which an individual becomes a member? If "Yes," describe the process.	Yes	No
9c	Do your members have voting rights, rights to participate in religious functions, or other rights? If "Yes," describe the rights your members have.	Yes	No
9d	May your members be associated with another denomination or church?	Yes	No
9e	Are all of your members part of the same family?	Yes	No
10	Do you conduct baptisms, weddings, funerals, or other religious rites?	Yes	No
11	Do you have a school for the religious instruction of the young?	Yes	No
12	Do you have ministers or religious leaders? If "Yes," describe these roles and explain whether the ministers or religious leaders are ordained, commissioned, or licensed after a prescribed course of study.	Yes	No
13	Do you have schools for the preparation of your ordained ministers or religious leaders?	Yes	No
14	Do you ordain, commission, or license ministers or religious leaders? If "Yes," describe the requirements for ordination, commission, or licensure.	Yes	No
15	Do you have other information you believe should be considered regarding your status as a church? If "Yes," explain.	Yes	No

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Schedule B. Schools, Colleges, and Universities

1 Do you normally have a regularly scheduled curriculum, a regular faculty of qualified teachers, a regularly enrolled student body, and facilities where your educational activities are regularly carried on? ◯ Yes ◯ No

2 Is the primary function of your school the presentation of formal instruction? If "No," continue to Line 3. ◯ Yes ◯ No

2a Select the best description(s) of your school:

- ☐ Elementary school
- ☐ Secondary school
- ☐ Charter school
- ☐ College or university
- ☐ Technical school
- ☐ Other school (describe)

3 Are you a public school because you are operated by a state or subdivision of a state or operated wholly or predominantly from government funds or property? If "Yes," explain how you are operated by a state or subdivision of a state. Do not complete the remainder of Schedule B. ◯ Yes ◯ No

4 Were you formed or substantially expanded at the time of public school desegregation in the school district or county in which you are located? ◯ Yes ◯ No

5 Has a state or federal administrative agency or judicial body ever determined that you are racially discriminatory? If "Yes," explain. ◯ Yes ◯ No

6 Has your right to receive financial aid or assistance from a governmental agency ever been revoked or suspended? If "Yes," explain. ◯ Yes ◯ No

Information Required by Revenue Procedure 75-50 as Modified by Revenue Procedure 2019-22

7 Have you adopted a racially nondiscriminatory policy as to students in your organizing document, bylaws, or by resolution of your governing body? ◯ Yes ◯ No

State where the policy is located or if adopted by resolution of your governing body.

8 Do your brochures, application forms, advertisements, and catalogues dealing with student admissions, programs, and scholarships contain a statement of your racially nondiscriminatory policy? If "Yes," continue to Line 9. ◯ Yes ◯ No

8a ☐ By checking this box, you agree that all future printed materials, including website content, will contain the required nondiscriminatory policy statement.

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Schedule B. Schools, Colleges, and Universities *(continued)*

9 Have you made your racially nondiscriminatory policy known to all segments of the general community you serve by: a) publishing a notice of your policy in a newspaper of general circulation that serves all racial segments of the community; b) publicizing your policy over broadcast media in a way that is reasonably expected to be effective; or c) displaying a notice of your policy at all times on your primary, publicly accessible internet home page in a manner reasonably expected to be noticed by visitors to the homepage? If "Yes," continue to Line 10. ◯ Yes ◯ No

9a ☐ By checking this box, you agree that you will publicize your nondiscriminatory policy in a way that meets the requirements of Revenue Procedure 75-50, 1975-2 C.B. 587, as modified by Revenue Procedure 2019-22, I.R.B. 1260.

10 Do or will you (or any department or division of your organization) discriminate in any way on the basis of race with respect to admissions, use of facilities or exercise of student privileges, faculty or administrative staff, or scholarship or loan programs? If "Yes," for any of the above, explain fully. ◯ Yes ◯ No

11 Complete the table below to show the racial composition for the current academic year and projected for the next academic year. If you are not operational, submit an estimate based on the best information available (such as the racial composition of the community you serve).

For each racial category, enter the number of (a) students, (b) faculty, and (c) administrative staff. Provide actual numbers rather than percentages for each racial category.

Racial Category	**(a) Student Body**		**(b) Faculty**		**(c) Administrative Staff**	
	Current Year	Next Year	Current Year	Next Year	Current Year	Next Year
Total						

12 In the table below, enter the number and amount of loans and scholarships awarded to enrolled students by racial categories. Provide actual numbers rather than percentages for each racial category.

☐ Check here if you will not provide any loans or scholarships to students.

Racial Category	**Number of Loans**		**Amount of Loans**		**Number of Scholarships**		**Amount of Scholarships**	
	Current Year	Next Year	Current Year	Next Year	Current Year	Next Year	Current Year	Next Year
Total								

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Schedule B. Schools, Colleges, and Universities *(continued)*

13 List your incorporators, founders, board members, and donors of land or buildings, whether individuals or organizations.

14 Do any of your incorporators, founders, board members, and donors of land or buildings, whether individuals or organizations, have an objective to maintain segregated public or private school education? If "Yes," explain. ◯ Yes ◯ No

15 Will you maintain records according to the nondiscrimination provisions contained in Revenue Procedure 75-50? If "No," explain. ◯ Yes ◯ No

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Schedule C. Hospitals and Medical Research Organizations

1 Are you a medical research organization (an organization whose principal purpose or function is medical research and which is directly engaged in the continuous active conduct of medical research) operated in conjunction with a hospital? If "No," continue to Line 2. ◯ Yes ◯ No

1a Name the hospitals with which you have a relationship and describe the relationship.

1b List your assets showing their fair market value and the portion of your assets directly devoted to medical research.

Do not complete the remainder of Schedule C.

2 Are you applying for exemption as a cooperative hospital service organization described in section 501(e)? If "Yes," explain. ◯ Yes ◯ No

Do not complete the remainder of Schedule C.

3 Are all the doctors in the community eligible for staff privileges? If "No," give the reasons why and explain how the medical staff is selected. ◯ Yes ◯ No

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Schedule C. Hospitals and Medical Research Organizations *(continued)*

4 Do or will you provide medical services to all individuals in your community who can pay for themselves or are able to pay through some form of insurance? If "No," explain. ◯ Yes ◯ No

5 Do you or will you maintain a full-time emergency room? If "Yes," continue to Line 6. ◯ Yes ◯ No

5a Are you a specialty hospital or would emergency services be duplicative based on your region or locality? ◯ Yes ◯ No

6 Do you provide free or below cost services? If "Yes," describe your policy for determining when and to whom you provide these services and how these services promote the organization's benefit to the community. ◯ Yes ◯ No

7 Do you or will you carry on a formal program of medical training or medical research? If "Yes," describe such programs, including the type of programs offered, the scope of such programs, and affiliations with other hospitals or medical care providers with which you carry on the medical training or research programs. ◯ Yes ◯ No

8 Do you or will you carry on a formal program of community education? If "Yes," describe such programs, including the type of programs offered, the scope of such programs, and affiliation with other hospitals or medical care providers with which you offer community education programs. ◯ Yes ◯ No

Schedule C. Hospitals and Medical Research Organizations *(continued)*

9 Is your board of directors composed of a majority of individuals who are representative of the community you serve, or do you operate under a parent organization whose board of directors is composed of a majority of individuals who are representative of the community you serve? If "Yes," continue to Line 10. ◯ Yes ◯ No

9a List each board member's name and business, financial, or professional relationship with the hospital. Also, identify each board member who is representative of the community and describe how that individual is a community representative. If you operate under a parent organization whose board of directors is not composed of a majority of individuals who are representative of the community you serve, provide the requested information for your parent's board of directors as well.

10 Do you operate a facility which is required by a state to be licensed, registered, or similarly recognized as a hospital? If "No," do not complete the rest of Schedule C. ◯ Yes ◯ No

10a Do you conduct a community health needs assessment (CHNA) at least once every three years and adopt an implementation strategy to meet the community health needs identified in the assessment as required by section 501(r)(3)? If "No," explain. ◯ Yes ◯ No

10b Do you have a written financial assistance policy (FAP) and a written policy relating to emergency medical care as required by section 501(r)(4)? If "No," explain. ◯ Yes ◯ No

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Schedule C. Hospitals and Medical Research Organizations *(continued)*

10c Do you both (1) limit amounts charged for emergency or other medically necessary care provided to individuals eligible for assistance under your FAP to not more than amounts generally billed to individuals who have insurance covering such care, and (2) prohibit use of gross charges as required by section 501(r)(5)? If "No," explain. ◯ Yes ◯ No

10d Do you make reasonable efforts to determine whether an individual is FAP-eligible before engaging in extraordinary collection actions as required by section 501(r)(6)? If "No," explain. ◯ Yes ◯ No

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Schedule D. Section 509(a)(3) Supporting Organizations

1 List the names, addresses, and EINs of the organizations you support.

2 Are all your supported organizations public charities under section 509(a)(1) or (2)? If "Yes," continue to Line 3. ◯ Yes ◯ No

2a Are your supported organizations tax exempt under section 501(c)(4), 501(c)(5), or 501(c)(6) and do your supported organizations meet the public support test under section 509(a)(2)? If "No," explain how each organization you support is a public charity under section 509(a)(1) or 509(a)(2). ◯ Yes ◯ No

3 Which of the following describes your relationship with your supported organization(s)?

◯ A majority of your governing board or officers are elected or appointed by your supported organization(s). (Type I supporting organization)

◯ Your control or management is vested in the same persons who control or manage your supported organization(s). (Type II supporting organization)

◯ One or more of your officers, directors, or trustees are elected or appointed by the officers, directors, trustees, or membership of your supported organization(s), or one or more of your officers, directors, trustees, or other important office holders, are also members of the governing body of your supported organization(s), or your officers, directors, or trustees maintain a close and continuous working relationship with the officers, directors, or trustees of your supported organization(s). (Type III supporting organization)

4 Describe how your governing board and officers are selected. If you are a Type III organization, also describe how your officers, directors, or trustees maintain a close and continuous working relationship with the officers, directors, or trustees of your supported organization(s).

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Schedule D. Section 509(a)(3) Supporting Organizations *(continued)*

5 Do any persons who are disqualified persons (except individuals who are disqualified persons only because they are foundation managers) with respect to you or persons who have a family or business relationship with any disqualified persons appoint any of your foundation managers? If "Yes," (1) describe the process by which disqualified persons appoint any of your foundation managers, (2) provide the names of these disqualified persons and the foundation managers they appoint, and (3) explain how control is vested over your operations (including assets and activities) by persons other than disqualified persons. ◯ Yes ◯ No

6 Do any persons who are disqualified persons (except individuals who are disqualified persons only because they are foundation managers) have any influence regarding your operations, including your assets or activities? If "Yes," (1) provide the names of these disqualified persons, (2) explain how influence is exerted over your operations (including assets and activities), and (3) explain how control is vested over your operations (including assets and activities) by individuals other than disqualified persons. ◯ Yes ◯ No

7 Does your organizing document specify your supported organization(s) by name? ◯ Yes ◯ No
If "Yes" and you selected Type I above, continue to Line 8.
If "Yes," and you selected Type II, do not complete the rest of Schedule D.
If "No" and you selected Type III above, amend your organizing document to specify your supported organization(s) by name or you will not meet the organizational test and need to reconsider your requested public charity classification; then continue to Line 8.

7a Does your organizing document name a similar purpose or charitable class of beneficiaries as to your supported organization(s)? If "No," amend your organizing document to specify your supported organization(s) by name, purpose, or class or you will not meet the organizational test and need to reconsider your requested public charity classification. ◯ Yes ◯ No

If you selected Type II above, do not complete the rest of Schedule D.

8 Do you or will you receive contributions from any person who alone, or combined with family members or an entity at least 35% controlled by that person, controls any of your supported organizations, or will you receive contributions from any family member of, or an entity at least 35% controlled by, any person who controls any of your supported organizations? If "Yes," explain. ◯ Yes ◯ No

If you selected Type I above, do not complete the rest of Schedule D.

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Schedule D. Section 509(a)(3) Supporting Organizations *(continued)*

9 Do the officers, directors, or trustees of your supported organization have a significant voice in your investment policies, the timing and making of grants, the selection of grant recipients, and in otherwise directing the use of your income or assets? If "Yes," explain. Yes No

10 In each taxable year, do you or will you provide each of your supported organizations with (a) a written notice addressed to a principal officer of the supported organization describing the type and amount of all of the support you provided to the supported organization during the immediately preceding taxable year, (b) a copy of your most recently filed Form 990-series return or notice, and (c) a copy of your governing documents? If 'No,' explain. Yes No

11 Do you exercise a substantial degree of direction over the policies, programs, and activities of your supported organization(s) and appoint or elect (directly or indirectly) a majority of the officers, directors, or trustees of your supported organization(s)? If "Yes," explain. Yes No

12 Do substantially all of your activities directly further the exempt purposes of one or more supported organizations to which you are responsive by performing the functions of, or carrying out the purposes of, such supported organization(s) and but for your involvement would normally be engaged in by such supported organization(s). If "Yes," explain and do not complete the rest of Schedule D. Yes No

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Schedule D. Section 509(a)(3) Supporting Organizations *(continued)*

13 Do you distribute at least 85% of your annual net income or 3.5% of the aggregate fair market value of all of your non-exempt-use assets (whichever is greater) to your supported organization(s)? If "No," explain. ◯ Yes ◯ No

13a How much do you contribute annually to each supported organization?

13b What is the total annual revenue of each supported organization?

13c Do you or the supported organization(s) earmark your funds for support of a particular program or activity? If "Yes," explain. ◯ Yes ◯ No

Form **1023** (Rev. 01-2020)

Form 1023 (Rev 01-2020) Name: EIN: Page **32**

Schedule E. Effective Date

1 Are you applying for reinstatement of exemption after being automatically revoked for failure to file required returns or notices for three consecutive years? If "No," continue to Line 2. ◯ Yes ◯ No

1a Revenue Procedure 2014-11, 2014-1 C.B. 411, provides procedures for reinstating your tax-exempt status. Select the section of Revenue Procedure 2014-11 under which you want us to consider your reinstatement request.

◯ Section 4. You are seeking retroactive reinstatement under section 4 of Revenue Procedure 2014-11. By selecting this line, you attest that you meet the specified requirements of section 4, that your failure to file was not intentional, and that you have put in place procedures to file required returns or notices in the future. Do not complete the rest of Schedule E.

◯ Section 5. You are seeking retroactive reinstatement under section 5 of Revenue Procedure 2014-11. By selecting this line, you attest that you meet the specified requirements of section 5, that you have filed required annual returns, that your failure to file was not intentional, and that you have put in place procedures to file required returns or notices in the future.

Describe how you exercised ordinary business care and prudence in determining and attempting to comply with your filing requirements in at least one of the three years of revocation and the steps you have taken or will take to avoid or mitigate future failures to file timely returns or notices. Do not complete the rest of Schedule E.

◯ Section 6. You are seeking retroactive reinstatement under section 6 of Revenue Procedure 2014-11. By selecting this line, you attest that you meet the specified requirements of section 6, that you have filed required annual returns, that your failure to file was not intentional, and that you have put in place procedures to file required returns or notices in the future.

Describe how you exercised ordinary business care and prudence in determining and attempting to comply with your filing requirements in each of the three years of revocation and the steps you have taken or will take to avoid or mitigate future failures to file timely returns or notices. Do not complete the rest of Schedule E.

◯ Section 7. You are seeking reinstatement under section 7 of Revenue Procedure 2014-11, effective the date you are filling this application. Do not complete the rest of Schedule E.

2 Generally, if you did not file Form 1023 within 27 months of formation, the effective date of your exempt status will be the date you filed Form 1023 (submission date). Requests for an earlier effective date may be granted when there is evidence to establish you acted reasonably and in good faith and the grant of relief will not prejudice the interests of the government.

◯ Check this box if you accept the submission date as the effective date of your exempt status. Do not complete the rest of Schedule E.

◯ Check this box if you are requesting an earlier effective date than the submission date.

2a Explain why you did not file Form 1023 within 27 months of formation, how you acted reasonably and in good faith, and how granting an earlier effective date will not prejudice the interests of the Government.

You may want to include the events that led to the failure to timely file Form 1023 and to the discovery of the failure, any reliance on the advice of a qualified tax professional and a description of the engagement and responsibilities of the professional as well as the extent to which you relied on the professional, a comparison of (1) what your aggregate tax liability would be if you had filed this application within the 27-month period with (2) what your aggregate liability would be if you were exempt as of your formation date, or any other information you believe will support your request for relief.

Form **1023** (Rev. 01-2020)

Form 1023 (Rev 01-2020) Name: EIN: Page **33**

Schedule F. Low-Income Housing

1 Describe each facility including the type of facility, whether you own or lease the facility, how many residents it can accommodate, the current number of residents, and whether the residents purchase or rent housing from you.

2 Describe who qualifies for your housing in terms of income levels or other criteria and explain how you select residents.

3 Do you meet the safe harbor requirements outlined in Revenue Procedure 96-32, 1996-1 C.B. 717, which provides guidelines for providing low-income housing that will be treated as charitable, including for each project that (a) at least 75 percent of the units are occupied by residents that qualify as low-income and (b) either at least 20 percent of the units are occupied by residents that also meet the very low-income limit for the area or 40 percent of the units are occupied by residents that also do not exceed 120 percent of the area's very low-income limit, and less than 25 percent of the units are provided at market rates to persons who have incomes in excess of the low-income limit? ◯ Yes ◯ No

4 Is your housing affordable to low-income residents? If "Yes," describe how your housing is made affordable to low-income residents. ◯ Yes ◯ No

5 Do you impose any restrictions to make sure that your housing remains affordable to low-income residents? If "Yes," describe these restrictions. ◯ Yes ◯ No

Form **1023** (Rev. 01-2020)

Schedule F. Low-Income Housing *(continued)*

6 In addition to rent or mortgage payments, do residents pay periodic fees or maintenance charges? If "Yes," describe what these charges cover and how they are determined. ◯ Yes ◯ No

7 Do you provide social services to residents? If "Yes," describe these services. ◯ Yes ◯ No

8 Do you participate in any government housing programs? If "Yes," describe these programs. ◯ Yes ◯ No

Form 1023 (Rev 01-2020) Name: EIN: Page **35**

Schedule G. Successors to Other Organizations

1 List the name, last address, and EIN of your predecessor organization and describe its activities.

2 List the owners, partners, principal stockholders, officers, and governing board members of your predecessor organization. Include their names, addresses, and share/interest in the predecessor organization (if for-profit).

3 Are you a successor to a for-profit organization? If "Yes," explain your relationship with the predecessor organization that resulted in your creation and explain why you took over the activities or assets of a for-profit organization or converted from for-profit to nonprofit status; continue to Line 4. ◯ Yes ◯ No

3a Explain your relationship with the other organization that resulted in your creation and why you took over the activities or assets of another organization.

Form **1023** (Rev. 01-2020)

Schedule G. Successors to Other Organizations *(continued)*

4 Do or will you maintain a working relationship with any of the persons listed in question 2 or with any for-profit organization in which these persons own more than a 35% interest? If "Yes," describe the relationship. ◯ Yes ◯ No

5 Were any assets transferred, whether by gift or sale, from the predecessor organization to you? If "Yes," provide a list of assets, indicate the value of each asset, explain how the value was determined, and attach an appraisal, if available. For each asset listed, also explain if the transfer was by gift, sale, or combination thereof and describe any restrictions that were placed on the use or sale of the assets. ◯ Yes ◯ No

6 Were any debts or liabilities transferred from the predecessor for-profit organization to you? If "Yes," provide a list of the debts or liabilities that were transferred to you, indicating the amount of each, how the amount was determined, and the name of the person to whom the debt or liability is owed. ◯ Yes ◯ No

7 Will you lease or rent any property or equipment to or from the predecessor organization or any persons listed in Line 2 or a for-profit organization in which these persons own more than a 35% interest? If "Yes," describe the arrangement(s) including how the lease or rental value was determined. ◯ Yes ◯ No

Schedule H. Organizations Providing Scholarships, Fellowships, Educational Loans, or Other Educational Grants to Individuals and Private Foundations Requesting Advance Approval of Individual Grant Procedures

Section I **Public charities and private foundations complete lines 1 through 8 of this section.**

1 Describe the types of educational grants you provide to individuals, such as scholarships, fellowships, loans, etc., including the purpose, number and amount(s) of grants, how the program is publicized, and if you award educational loans, the terms of the loans.

2 Do you maintain case histories showing recipients of your scholarships, fellowships, educational loans, or other educational grants, including names, addresses, purposes of awards, amount of each grant, manner of selection, and relationship (if any) to officers, trustees, or donors of funds to you? If "No," explain. ◯ Yes ◯ No

3 Describe the specific criteria you use to determine who is eligible for your program (for example, eligibility selection criteria could consist of graduating high school students from a particular high school who will attend college, writers of scholarly works about American history, etc.).

4 Describe the specific criteria you use to select recipients (for example, specific selection criteria could consist of prior academic performance, financial need, etc.).

Form 1023 (Rev 01-2020) Name: EIN: Page **38**

Schedule H. Organizations Providing Scholarships, Fellowships, Educational Loans, or Other Educational Grants to Individuals and Private Foundations Requesting Advance Approval of Individual Grant Procedures *(continued)*

5 Describe any requirement or condition you impose on recipients to obtain, maintain, or qualify for renewal of a grant (for example, specific requirements or conditions could consist of attendance at a four-year college, maintaining a certain grade point average, teaching in public school after graduation from college, etc.).

6 Describe your procedures for supervising the scholarships, fellowships, educational loans, or other educational grants. Explain whether you obtain reports and grade transcripts from recipients, or you pay grants directly to a school under an arrangement whereby the school will apply the grant funds only for enrolled students who are in good standing. Also, describe your procedures for taking action if the terms of the award are violated.

7 How do you determine who is on the selection committee for the awards made under your program?

8 Are relatives of members of the selection committee, or of your officers, directors, or substantial contributors eligible for awards made under your program? If "Yes," what measures do you take to ensure unbiased selections? ◯ Yes ◯ No

Do not complete the rest of Schedule H. If you are a private foundation, you will be directed to complete Section II of Schedule H later in the application.

Form **1023** (Rev. 01-2020)

Form 1023 (Rev 01-2020) Name: EIN: Page **39**

Schedule H. Organizations Providing Scholarships, Fellowships, Educational Loans, or Other Educational Grants to Individuals and Private Foundations Requesting Advance Approval of Individual Grant Procedures *(continued)*

Section II **Private foundations complete lines 1 through 7 of this section. Public charities do not complete this section.**

1 As a private foundation, do you want this application to be considered as a request for advance approval of grant making procedures? ◯ Yes ◯ No

If "No," do not complete the rest of Schedule H.

1a Check the box(es) indicating under which section(s) you want your grant making procedures to be considered.

☐ 4945(g)(1) - Scholarship or fellowship grant to an individual for study at an educational institution

☐ 4945(g)(3) - Other grants, including loans, to an individual for travel, study, or other similar purposes, to enhance a particular skill of the grantee or to produce a specific product

2 Do you represent that you will (1) arrange to receive and review grantee reports annually and upon completion of the purpose for which the grant was awarded, (2) investigate diversions of funds from their intended purposes, and (3) take all reasonable and appropriate steps to recover diverted funds, ensure other grant funds held by a grantee are used for their intended purposes, and withhold further payments to grantees until you obtain grantees' assurances that future diversions will not occur and that grantees will take extraordinary precautions to prevent future diversions from occurring? ◯ Yes ◯ No

3 Do you represent that you will maintain all records relating to individual grants, including information obtained to evaluate grantees, identify whether a grantee is a disqualified person, establish the amount and purpose of each grant, and establish that you undertook the supervision and investigation of grants described in Line 2? ◯ Yes ◯ No

4 Do you or will you award scholarships, fellowships, and educational loans to attend an educational institution based on the status of an individual being an employee of a particular employer? ◯ Yes ◯ No

If "No," do not complete the rest of Schedule H.

5 Will you comply with the seven conditions and either the percentage tests or facts and circumstances test for scholarships, fellowships, and educational loans to attend an educational institution as set forth in Revenue Procedures 76-47, 1976-2 C.B. 670, and 80-39, 1980-2 C.B. 772, which apply to inducement, selection committee, eligibility requirements, objective basis of selection, employment, course of study, and other objectives? ◯ Yes ◯ No

6 Do you or will you provide scholarships, fellowships, or educational loans to attend an educational institution to employees of a particular employer? If "No," continue to Line 7. ◯ Yes ◯ No

6a Will you award grants to 10% or fewer of the eligible applicants who were actually considered by the selection committee in selecting recipients of grants in that year as provided by Revenue Procedures 76-47 and 80-39? ◯ Yes ◯ No

7 Do you provide scholarships, fellowships, or educational loans to attend an educational institution to children of employees of a particular employer? ◯ Yes ◯ No

If "No," do not complete the rest of Schedule H.

7a Will you award grants to 25% or fewer of the eligible applicants who were actually considered by the selection committee in selecting recipients of grants in that year as provided by Revenue Procedures 76-47 and 80-39? ◯ Yes ◯ No

If "Yes," do not complete the rest of Schedule H.

Form **1023** (Rev. 01-2020)

Schedule H. Organizations Providing Scholarships, Fellowships, Educational Loans, or Other Educational Grants to Individuals and Private Foundations Requesting Advance Approval of Individual Grant Procedures *(continued)*

7b Will you award grants to 10% or fewer of the number of employees' children who can be shown to be eligible for grants (whether or not they submitted an application) in that year, as provided by Revenue Procedures 76-47 and 80-39? If "Yes," describe how you will determine who can be shown to be eligible for grants without submitting an application, such as by obtaining written statements or other information about the expectations of employees' children to attend an educational institution; do not complete the rest of Schedule H. ◯ Yes ◯ No

7c Will you award grants based on facts and circumstances that demonstrate that the grants will not be considered compensation for past, present, or future services or otherwise provide a significant benefit to the particular employer? If "Yes," describe the facts and circumstances you believe will demonstrate that the grants are neither compensatory nor a significant benefit to the particular employer. In your explanation, describe why you cannot satisfy either the 25% test or the 10% test in questions 7a and 7b. ◯ Yes ◯ No

EXHIBIT C:
IRS FORM 8940, REQUEST FOR MISCELLANEOUS DETERMINATION

Form **8940**
(Rev. June 2011)
Department of the Treasury
Internal Revenue Service

Request for Miscellaneous Determination

Under Section 507, 509(a), 4940, 4942, 4945, and 6033 of the Internal Revenue Code

OMB No. 1545-2211

Use the instructions to complete this form. **A User Fee must be attached to this form, if required.** For user fee information or additional help, visit our website at *www.irs.gov/eo* or call IRS Exempt Organizations Customer Account Services toll-free at 1-877-829-5500. If the required information and documents are not submitted with payment of the appropriate user fee, the form may be returned to you.

Part I Identification of Organization

1a Full Name of Organization

b Address (number, street and room/suite) If a P.O. Box, see instructions.	**c** City	**d** State	**e** Zip Code + 4

2 Employer Identification Number	**3** Month Tax Year Ends (MM)	**4** Person to Contact if More Information is Needed

5 Contact Telephone Number	**6** Fax Number (optional)	**7** User Fee Submitted

Part II Type of Request

8 Please select the item(s) below that best describe your request. Using an attachment, provide a detailed explanation of your request. Be sure to include the organization's name and EIN on each additional sheet.

a ☐ Advance approval of certain set-asides described in section 4942(g)(2)

b ☐ Advance approval of voter registration activities described in section 4945(f)

c ☐ Advance approval of scholarship procedures described in section 4945(g)

d ☐ Exemption from Form 990 filing requirements

e ☐ Advance approval that a potential grant or contribution constitutes an "unusual grant"

f ☐ Change in Type (or initial determination of Type) of a section 509(a)(3) organization

g ☐ Reclassification of foundation status, including a voluntary request from a public charity for private foundation status

h ☐ Termination of private foundation status under section 507(b)(1)(B)—advance ruling request

i ☐ Termination of private foundation status under section 507(b)(1)(B)—60-month period ended

Under penalties of perjury, I declare that I have examined this application, including accompanying statements and schedules, and to the best of my knowledge and belief, it is true, correct, and complete.

Please Sign Here

(Signature of Officer, Director, Trustee or other authorized official.) (Date)

(Type or print name of signer) (Type or print title or authority of signer)

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 37756H Form **8940** (Rev. 6-2011)

EXHIBIT D:
IRS FORM 990, RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX

Form **990**

Department of the Treasury
Internal Revenue Service

Return of Organization Exempt From Income Tax

Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations)

► **Do not enter social security numbers on this form as it may be made public.**

► **Go to *www.irs.gov/Form990* for instructions and the latest information.**

OMB No. 1545-0047

2021

Open to Public Inspection

A For the 2021 calendar year, or tax year beginning , 2021, and ending , 20

B Check if applicable:
- ☐ Address change
- ☐ Name change
- ☐ Initial return
- ☐ Final return/terminated
- ☐ Amended return
- ☐ Application pending

C Name of organization

Doing business as

Number and street (or P.O. box if mail is not delivered to street address) | Room/suite

City or town, state or province, country, and ZIP or foreign postal code

D Employer identification number

E Telephone number

G Gross receipts $

F Name and address of principal officer:

H(a) Is this a group return for subordinates? ☐ **Yes** ☐ **No**

H(b) Are all subordinates included? ☐ **Yes** ☐ **No**

If "No," attach a list. See instructions.

I Tax-exempt status: ☐ 501(c)(3) ☐ 501(c) ( ) ◄ (insert no.) ☐ 4947(a)(1) or ☐ 527

J Website: ►

H(c) Group exemption number ►

K Form of organization: ☐ Corporation ☐ Trust ☐ Association ☐ Other ► **L** Year of formation: **M** State of legal domicile:

Part I Summary

Activities & Governance

1	Briefly describe the organization's mission or most significant activities:		
2	Check this box ► ☐ if the organization discontinued its operations or disposed of more than 25% of its net assets.		
3	Number of voting members of the governing body (Part VI, line 1a)	3	
4	Number of independent voting members of the governing body (Part VI, line 1b)	4	
5	Total number of individuals employed in calendar year 2021 (Part V, line 2a)	5	
6	Total number of volunteers (estimate if necessary)	6	
7a	Total unrelated business revenue from Part VIII, column (C), line 12	7a	
b	Net unrelated business taxable income from Form 990-T, Part I, line 11	7b	

			Prior Year	**Current Year**
Revenue	8	Contributions and grants (Part VIII, line 1h)		
	9	Program service revenue (Part VIII, line 2g)		
	10	Investment income (Part VIII, column (A), lines 3, 4, and 7d)		
	11	Other revenue (Part VIII, column (A), lines 5, 6d, 8c, 9c, 10c, and 11e)		
	12	Total revenue—add lines 8 through 11 (must equal Part VIII, column (A), line 12)		
Expenses	13	Grants and similar amounts paid (Part IX, column (A), lines 1–3)		
	14	Benefits paid to or for members (Part IX, column (A), line 4)		
	15	Salaries, other compensation, employee benefits (Part IX, column (A), lines 5–10)		
	16a	Professional fundraising fees (Part IX, column (A), line 11e)		
	b	Total fundraising expenses (Part IX, column (D), line 25) ►		
	17	Other expenses (Part IX, column (A), lines 11a–11d, 11f–24e)		
	18	Total expenses. Add lines 13–17 (must equal Part IX, column (A), line 25)		
	19	Revenue less expenses. Subtract line 18 from line 12		

			Beginning of Current Year	**End of Year**
Net Assets or Fund Balances	20	Total assets (Part X, line 16)		
	21	Total liabilities (Part X, line 26)		
	22	Net assets or fund balances. Subtract line 21 from line 20		

Part II Signature Block

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

Sign Here

Signature of officer | Date

Type or print name and title

Paid Preparer Use Only				
Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ►			Firm's EIN ►	
Firm's address ►			Phone no.	

May the IRS discuss this return with the preparer shown above? See instructions ☐ **Yes** ☐ **No**

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11282Y Form **990** (2021)

Form 990 (2021) Page **2**

Part III **Statement of Program Service Accomplishments**

Check if Schedule O contains a response or note to any line in this Part III . . . . ☐

1 Briefly describe the organization's mission:

2 Did the organization undertake any significant program services during the year which were not listed on the prior Form 990 or 990-EZ? . . . . ☐ **Yes** ☐ **No**

If "Yes," describe these new services on Schedule O.

3 Did the organization cease conducting, or make significant changes in how it conducts, any program services? . . . . ☐ **Yes** ☐ **No**

If "Yes," describe these changes on Schedule O.

4 Describe the organization's program service accomplishments for each of its three largest program services, as measured by expenses. Section 501(c)(3) and 501(c)(4) organizations are required to report the amount of grants and allocations to others, the total expenses, and revenue, if any, for each program service reported.

4a (Code:) (Expenses $ including grants of $) (Revenue $)

4b (Code:) (Expenses $ including grants of $) (Revenue $)

4c (Code:) (Expenses $ including grants of $) (Revenue $)

4d Other program services (Describe on Schedule O.)
(Expenses $ including grants of $) (Revenue $)

4e Total program service expenses ▶

Form **990** (2021)

Form 990 (2021) Page 3

Part IV Checklist of Required Schedules

			Yes	No
1	Is the organization described in section 501(c)(3) or 4947(a)(1) (other than a private foundation)? *If "Yes," complete Schedule A*	1		
2	Is the organization required to complete *Schedule B, Schedule of Contributors*? See instructions	2		
3	Did the organization engage in direct or indirect political campaign activities on behalf of or in opposition to candidates for public office? *If "Yes," complete Schedule C, Part I*	3		
4	**Section 501(c)(3) organizations.** Did the organization engage in lobbying activities, or have a section 501(h) election in effect during the tax year? *If "Yes," complete Schedule C, Part II*	4		
5	Is the organization a section 501(c)(4), 501(c)(5), or 501(c)(6) organization that receives membership dues, assessments, or similar amounts as defined in Rev. Proc. 98-19? *If "Yes," complete Schedule C, Part III*	5		
6	Did the organization maintain any donor advised funds or any similar funds or accounts for which donors have the right to provide advice on the distribution or investment of amounts in such funds or accounts? *If "Yes," complete Schedule D, Part I*	6		
7	Did the organization receive or hold a conservation easement, including easements to preserve open space, the environment, historic land areas, or historic structures? *If "Yes," complete Schedule D, Part II*	7		
8	Did the organization maintain collections of works of art, historical treasures, or other similar assets? *If "Yes," complete Schedule D, Part III*	8		
9	Did the organization report an amount in Part X, line 21, for escrow or custodial account liability, serve as a custodian for amounts not listed in Part X; or provide credit counseling, debt management, credit repair, or debt negotiation services? *If "Yes," complete Schedule D, Part IV*	9		
10	Did the organization, directly or through a related organization, hold assets in donor-restricted endowments or in quasi endowments? *If "Yes," complete Schedule D, Part V*	10		
11	If the organization's answer to any of the following questions is "Yes," then complete Schedule D, Parts VI, VII, VIII, IX, or X, as applicable.			
a	Did the organization report an amount for land, buildings, and equipment in Part X, line 10? *If "Yes," complete Schedule D, Part VI*	11a		
b	Did the organization report an amount for investments—other securities in Part X, line 12, that is 5% or more of its total assets reported in Part X, line 16? *If "Yes," complete Schedule D, Part VII*	11b		
c	Did the organization report an amount for investments—program related in Part X, line 13, that is 5% or more of its total assets reported in Part X, line 16? *If "Yes," complete Schedule D, Part VIII*	11c		
d	Did the organization report an amount for other assets in Part X, line 15, that is 5% or more of its total assets reported in Part X, line 16? *If "Yes," complete Schedule D, Part IX*	11d		
e	Did the organization report an amount for other liabilities in Part X, line 25? *If "Yes," complete Schedule D, Part X*	11e		
f	Did the organization's separate or consolidated financial statements for the tax year include a footnote that addresses the organization's liability for uncertain tax positions under FIN 48 (ASC 740)? *If "Yes," complete Schedule D, Part X*	11f		
12a	Did the organization obtain separate, independent audited financial statements for the tax year? *If "Yes," complete Schedule D, Parts XI and XII*	12a		
b	Was the organization included in consolidated, independent audited financial statements for the tax year? *If "Yes," and if the organization answered "No" to line 12a, then completing Schedule D, Parts XI and XII is optional*	12b		
13	Is the organization a school described in section 170(b)(1)(A)(ii)? *If "Yes," complete Schedule E*	13		
14a	Did the organization maintain an office, employees, or agents outside of the United States?	14a		
b	Did the organization have aggregate revenues or expenses of more than $10,000 from grantmaking, fundraising, business, investment, and program service activities outside the United States, or aggregate foreign investments valued at $100,000 or more? *If "Yes," complete Schedule F, Parts I and IV*	14b		
15	Did the organization report on Part IX, column (A), line 3, more than $5,000 of grants or other assistance to or for any foreign organization? *If "Yes," complete Schedule F, Parts II and IV*	15		
16	Did the organization report on Part IX, column (A), line 3, more than $5,000 of aggregate grants or other assistance to or for foreign individuals? *If "Yes," complete Schedule F, Parts III and IV.*	16		
17	Did the organization report a total of more than $15,000 of expenses for professional fundraising services on Part IX, column (A), lines 6 and 11e? *If "Yes," complete Schedule G, Part I.* See instructions	17		
18	Did the organization report more than $15,000 total of fundraising event gross income and contributions on Part VIII, lines 1c and 8a? *If "Yes," complete Schedule G, Part II*	18		
19	Did the organization report more than $15,000 of gross income from gaming activities on Part VIII, line 9a? *If "Yes," complete Schedule G, Part III*	19		
20a	Did the organization operate one or more hospital facilities? *If "Yes," complete Schedule H*	20a		
b	If "Yes" to line 20a, did the organization attach a copy of its audited financial statements to this return?	20b		
21	Did the organization report more than $5,000 of grants or other assistance to any domestic organization or domestic government on Part IX, column (A), line 1? *If "Yes," complete Schedule I, Parts I and II*	21		

Form **990** (2021)

Form 990 (2021) Page **4**

Part IV **Checklist of Required Schedules** *(continued)*

			Yes	No
22	Did the organization report more than $5,000 of grants or other assistance to or for domestic individuals on Part IX, column (A), line 2? *If "Yes," complete Schedule I, Parts I and III*	22		
23	Did the organization answer "Yes" to Part VII, Section A, line 3, 4, or 5, about compensation of the organization's current and former officers, directors, trustees, key employees, and highest compensated employees? *If "Yes," complete Schedule J*	23		
24a	Did the organization have a tax-exempt bond issue with an outstanding principal amount of more than $100,000 as of the last day of the year, that was issued after December 31, 2002? *If "Yes," answer lines 24b through 24d and complete Schedule K. If "No," go to line 25a*	24a		
b	Did the organization invest any proceeds of tax-exempt bonds beyond a temporary period exception?	24b		
c	Did the organization maintain an escrow account other than a refunding escrow at any time during the year to defease any tax-exempt bonds?	24c		
d	Did the organization act as an "on behalf of" issuer for bonds outstanding at any time during the year?	24d		
25a	**Section 501(c)(3), 501(c)(4), and 501(c)(29) organizations.** Did the organization engage in an excess benefit transaction with a disqualified person during the year? *If "Yes," complete Schedule L, Part I*	25a		
b	Is the organization aware that it engaged in an excess benefit transaction with a disqualified person in a prior year, and that the transaction has not been reported on any of the organization's prior Forms 990 or 990-EZ? *If "Yes," complete Schedule L, Part I*	25b		
26	Did the organization report any amount on Part X, line 5 or 22, for receivables from or payables to any current or former officer, director, trustee, key employee, creator or founder, substantial contributor, or 35% controlled entity or family member of any of these persons? *If "Yes," complete Schedule L, Part II*	26		
27	Did the organization provide a grant or other assistance to any current or former officer, director, trustee, key employee, creator or founder, substantial contributor or employee thereof, a grant selection committee member, or to a 35% controlled entity (including an employee thereof) or family member of any of these persons? *If "Yes," complete Schedule L, Part III*	27		
28	Was the organization a party to a business transaction with one of the following parties (see the Schedule L, Part IV, instructions for applicable filing thresholds, conditions, and exceptions):			
a	A current or former officer, director, trustee, key employee, creator or founder, or substantial contributor? *If "Yes," complete Schedule L, Part IV*	28a		
b	A family member of any individual described in line 28a? *If "Yes," complete Schedule L, Part IV*	28b		
c	A 35% controlled entity of one or more individuals and/or organizations described in line 28a or 28b? *If "Yes," complete Schedule L, Part IV*	28c		
29	Did the organization receive more than $25,000 in non-cash contributions? *If "Yes," complete Schedule M*	29		
30	Did the organization receive contributions of art, historical treasures, or other similar assets, or qualified conservation contributions? *If "Yes," complete Schedule M*	30		
31	Did the organization liquidate, terminate, or dissolve and cease operations? *If "Yes," complete Schedule N, Part I*	31		
32	Did the organization sell, exchange, dispose of, or transfer more than 25% of its net assets? *If "Yes," complete Schedule N, Part II*	32		
33	Did the organization own 100% of an entity disregarded as separate from the organization under Regulations sections 301.7701-2 and 301.7701-3? *If "Yes," complete Schedule R, Part I*	33		
34	Was the organization related to any tax-exempt or taxable entity? *If "Yes," complete Schedule R, Part II, III, or IV, and Part V, line 1*	34		
35a	Did the organization have a controlled entity within the meaning of section 512(b)(13)?	35a		
b	If "Yes" to line 35a, did the organization receive any payment from or engage in any transaction with a controlled entity within the meaning of section 512(b)(13)? *If "Yes," complete Schedule R, Part V, line 2*	35b		
36	**Section 501(c)(3) organizations.** Did the organization make any transfers to an exempt non-charitable related organization? *If "Yes," complete Schedule R, Part V, line 2*	36		
37	Did the organization conduct more than 5% of its activities through an entity that is not a related organization and that is treated as a partnership for federal income tax purposes? *If "Yes," complete Schedule R, Part VI*	37		
38	Did the organization complete Schedule O and provide explanations on Schedule O for Part VI, lines 11b and 19? **Note:** All Form 990 filers are required to complete Schedule O	38		

Part V **Statements Regarding Other IRS Filings and Tax Compliance**

Check if Schedule O contains a response or note to any line in this Part V ☐

					Yes	No
1a	Enter the number reported in box 3 of Form 1096. Enter -0- if not applicable	1a				
b	Enter the number of Forms W-2G included on line 1a. Enter -0- if not applicable	1b				
c	Did the organization comply with backup withholding rules for reportable payments to vendors and reportable gaming (gambling) winnings to prize winners?			1c		

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Part V **Statements Regarding Other IRS Filings and Tax Compliance** *(continued)*

					Yes	No
2a	Enter the number of employees reported on Form W-3, Transmittal of Wage and Tax Statements, filed for the calendar year ending with or within the year covered by this return	**2a**				
b	If at least one is reported on line 2a, did the organization file all required federal employment tax returns?			**2b**		
	Note: If the sum of lines 1a and 2a is greater than 250, you may be required to *e-file*. See instructions.					
3a	Did the organization have unrelated business gross income of $1,000 or more during the year?			**3a**		
b	If "Yes," has it filed a Form 990-T for this year? *If "No" to line 3b, provide an explanation on Schedule O*			**3b**		
4a	At any time during the calendar year, did the organization have an interest in, or a signature or other authority over, a financial account in a foreign country (such as a bank account, securities account, or other financial account)?			**4a**		
b	If "Yes," enter the name of the foreign country ▶ See instructions for filing requirements for FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR).					
5a	Was the organization a party to a prohibited tax shelter transaction at any time during the tax year?			**5a**		
b	Did any taxable party notify the organization that it was or is a party to a prohibited tax shelter transaction?			**5b**		
c	If "Yes" to line 5a or 5b, did the organization file Form 8886-T?			**5c**		
6a	Does the organization have annual gross receipts that are normally greater than $100,000, and did the organization solicit any contributions that were not tax deductible as charitable contributions?			**6a**		
b	If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible?			**6b**		
7	**Organizations that may receive deductible contributions under section 170(c).**					
a	Did the organization receive a payment in excess of $75 made partly as a contribution and partly for goods and services provided to the payor?			**7a**		
b	If "Yes," did the organization notify the donor of the value of the goods or services provided?			**7b**		
c	Did the organization sell, exchange, or otherwise dispose of tangible personal property for which it was required to file Form 8282?			**7c**		
d	If "Yes," indicate the number of Forms 8282 filed during the year	**7d**				
e	Did the organization receive any funds, directly or indirectly, to pay premiums on a personal benefit contract?			**7e**		
f	Did the organization, during the year, pay premiums, directly or indirectly, on a personal benefit contract?			**7f**		
g	If the organization received a contribution of qualified intellectual property, did the organization file Form 8899 as required?			**7g**		
h	If the organization received a contribution of cars, boats, airplanes, or other vehicles, did the organization file a Form 1098-C?			**7h**		
8	**Sponsoring organizations maintaining donor advised funds.** Did a donor advised fund maintained by the sponsoring organization have excess business holdings at any time during the year?			**8**		
9	**Sponsoring organizations maintaining donor advised funds.**					
a	Did the sponsoring organization make any taxable distributions under section 4966?			**9a**		
b	Did the sponsoring organization make a distribution to a donor, donor advisor, or related person?			**9b**		
10	**Section 501(c)(7) organizations.** Enter:					
a	Initiation fees and capital contributions included on Part VIII, line 12	**10a**				
b	Gross receipts, included on Form 990, Part VIII, line 12, for public use of club facilities	**10b**				
11	**Section 501(c)(12) organizations.** Enter:					
a	Gross income from members or shareholders	**11a**				
b	Gross income from other sources. (Do not net amounts due or paid to other sources against amounts due or received from them.)	**11b**				
12a	**Section 4947(a)(1) non-exempt charitable trusts.** Is the organization filing Form 990 in lieu of Form 1041?			**12a**		
b	If "Yes," enter the amount of tax-exempt interest received or accrued during the year	**12b**				
13	**Section 501(c)(29) qualified nonprofit health insurance issuers.**					
a	Is the organization licensed to issue qualified health plans in more than one state?			**13a**		
	Note: See the instructions for additional information the organization must report on Schedule O.					
b	Enter the amount of reserves the organization is required to maintain by the states in which the organization is licensed to issue qualified health plans	**13b**				
c	Enter the amount of reserves on hand	**13c**				
14a	Did the organization receive any payments for indoor tanning services during the tax year?			**14a**		
b	If "Yes," has it filed a Form 720 to report these payments? *If "No," provide an explanation on Schedule O*			**14b**		
15	Is the organization subject to the section 4960 tax on payment(s) of more than $1,000,000 in remuneration or excess parachute payment(s) during the year?			**15**		
	If "Yes," see the instructions and file Form 4720, Schedule N.					
16	Is the organization an educational institution subject to the section 4968 excise tax on net investment income?			**16**		
	If "Yes," complete Form 4720, Schedule O.					
17	**Section 501(c)(21) organizations.** Did the trust, any disqualified person, or mine operator engage in any activities that would result in the imposition of an excise tax under section 4951, 4952 or 4953?			**17**		
	If "Yes," complete Form 6069.					

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Part VI **Governance, Management, and Disclosure.** *For each "Yes" response to lines 2 through 7b below, and for a "No" response to line 8a, 8b, or 10b below, describe the circumstances, processes, or changes on Schedule O. See instructions.*

Check if Schedule O contains a response or note to any line in this Part VI . . . . ☐

Section A. Governing Body and Management

			Yes	No
1a	Enter the number of voting members of the governing body at the end of the tax year . . **1a** ______ If there are material differences in voting rights among members of the governing body, or if the governing body delegated broad authority to an executive committee or similar committee, explain on Schedule O.			
b	Enter the number of voting members included on line 1a, above, who are independent . **1b** ______			
2	Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee, or key employee?	2		
3	Did the organization delegate control over management duties customarily performed by or under the direct supervision of officers, directors, trustees, or key employees to a management company or other person? .	3		
4	Did the organization make any significant changes to its governing documents since the prior Form 990 was filed?	4		
5	Did the organization become aware during the year of a significant diversion of the organization's assets? .	5		
6	Did the organization have members or stockholders?	6		
7a	Did the organization have members, stockholders, or other persons who had the power to elect or appoint one or more members of the governing body?	7a		
b	Are any governance decisions of the organization reserved to (or subject to approval by) members, stockholders, or persons other than the governing body?	7b		
8	Did the organization contemporaneously document the meetings held or written actions undertaken during the year by the following:			
a	The governing body?	8a		
b	Each committee with authority to act on behalf of the governing body?	8b		
9	Is there any officer, director, trustee, or key employee listed in Part VII, Section A, who cannot be reached at the organization's mailing address? *If "Yes," provide the names and addresses on Schedule O*	9		

Section B. Policies *(This Section B requests information about policies not required by the Internal Revenue Code.)*

			Yes	No
10a	Did the organization have local chapters, branches, or affiliates?	10a		
b	If "Yes," did the organization have written policies and procedures governing the activities of such chapters, affiliates, and branches to ensure their operations are consistent with the organization's exempt purposes?	10b		
11a	Has the organization provided a complete copy of this Form 990 to all members of its governing body before filing the form?	11a		
b	Describe on Schedule O the process, if any, used by the organization to review this Form 990.			
12a	Did the organization have a written conflict of interest policy? *If "No," go to line 13*	12a		
b	Were officers, directors, or trustees, and key employees required to disclose annually interests that could give rise to conflicts?	12b		
c	Did the organization regularly and consistently monitor and enforce compliance with the policy? *If "Yes," describe on Schedule O how this was done*	12c		
13	Did the organization have a written whistleblower policy?	13		
14	Did the organization have a written document retention and destruction policy?	14		
15	Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision?			
a	The organization's CEO, Executive Director, or top management official	15a		
b	Other officers or key employees of the organization . . . . If "Yes" to line 15a or 15b, describe the process on Schedule O. See instructions.	15b		
16a	Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement with a taxable entity during the year?	16a		
b	If "Yes," did the organization follow a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law, and take steps to safeguard the organization's exempt status with respect to such arrangements?	16b		

Section C. Disclosure

17 List the states with which a copy of this Form 990 is required to be filed ► ______

18 Section 6104 requires an organization to make its Forms 1023 (1024 or 1024-A, if applicable), 990, and 990-T (section 501(c)(3)s only) available for public inspection. Indicate how you made these available. Check all that apply.

☐ Own website ☐ Another's website ☐ Upon request ☐ Other *(explain on Schedule O)*

19 Describe on Schedule O whether (and if so, how) the organization made its governing documents, conflict of interest policy, and financial statements available to the public during the tax year.

20 State the name, address, and telephone number of the person who possesses the organization's books and records ►

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Part VII **Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors**

Check if Schedule O contains a response or note to any line in this Part VII . . . . ☐

Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

1a Complete this table for all persons required to be listed. Report compensation for the calendar year ending with or within the organization's tax year.

• List all of the organization's **current** officers, directors, trustees (whether individuals or organizations), regardless of amount of compensation. Enter -0- in columns (D), (E), and (F) if no compensation was paid.

• List all of the organization's **current** key employees, if any. See the instructions for definition of "key employee."

• List the organization's five **current** highest compensated employees (other than an officer, director, trustee, or key employee) who received reportable compensation (box 5 of Form W-2, Form 1099-MISC, and/or box 1 of Form 1099-NEC) of more than $100,000 from the organization and any related organizations.

• List all of the organization's **former** officers, key employees, and highest compensated employees who received more than $100,000 of reportable compensation from the organization and any related organizations.

• List all of the organization's **former directors or trustees** that received, in the capacity as a former director or trustee of the organization, more than $10,000 of reportable compensation from the organization and any related organizations.

See the instructions for the order in which to list the persons above.

☐ Check this box if neither the organization nor any related organization compensated any current officer, director, or trustee.

(A) Name and title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)						(D) Reportable compensation from the organization (W-2/ 1099-MISC/ 1099-NEC)	(E) Reportable compensation from related organizations (W-2/ 1099-MISC/ 1099-NEC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former			
(1)										
(2)										
(3)										
(4)										
(5)										
(6)										
(7)										
(8)										
(9)										
(10)										
(11)										
(12)										
(13)										
(14)										

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Part VII **Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees** *(continued)*

(A) Name and title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee): Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former	(D) Reportable compensation from the organization (W-2/ 1099-MISC/ 1099-NEC)	(E) Reportable compensation from related organizations (W-2/ 1099-MISC/ 1099-NEC)	(F) Estimated amount of other compensation from the organization and related organizations
(15)										
(16)										
(17)										
(18)										
(19)										
(20)										
(21)										
(22)										
(23)										
(24)										
(25)										

1b Subtotal . . . . ▶

c Total from continuation sheets to Part VII, Section A . . . . . ▶

d Total (add lines 1b and 1c) . . . . ▶

2 Total number of individuals (including but not limited to those listed above) who received more than $100,000 of reportable compensation from the organization ▶

			Yes	No
3	Did the organization list any **former** officer, director, trustee, key employee, or highest compensated employee on line 1a? *If "Yes," complete Schedule J for such individual*	3		
4	For any individual listed on line 1a, is the sum of reportable compensation and other compensation from the organization and related organizations greater than $150,000? *If "Yes," complete Schedule J for such individual*	4		
5	Did any person listed on line 1a receive or accrue compensation from any unrelated organization or individual for services rendered to the organization? *If "Yes," complete Schedule J for such person*	5		

Section B. Independent Contractors

1 Complete this table for your five highest compensated independent contractors that received more than $100,000 of compensation from the organization. Report compensation for the calendar year ending with or within the organization's tax year.

(A) Name and business address	(B) Description of services	(C) Compensation

2 Total number of independent contractors (including but not limited to those listed above) who received more than $100,000 of compensation from the organization ▶

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Part VIII Statement of Revenue

Check if Schedule O contains a response or note to any line in this Part VIII . . . . ☐

Section	Line	Description			(A) Total revenue	(B) Related or exempt function revenue	(C) Unrelated business revenue	(D) Revenue excluded from tax under sections 512–514
Contributions, Gifts, Grants, and Other Similar Amounts	1a	Federated campaigns	1a					
	b	Membership dues	1b					
	c	Fundraising events	1c					
	d	Related organizations	1d					
	e	Government grants (contributions)	1e					
	f	All other contributions, gifts, grants, and similar amounts not included above	1f					
	g	Noncash contributions included in lines 1a–1f	1g	$				
	h	**Total.** Add lines 1a–1f . . . ▶						
Program Service Revenue				Business Code				
	2a							
	b							
	c							
	d							
	e							
	f	All other program service revenue						
	g	**Total.** Add lines 2a–2f . . . ▶						
Other Revenue	3	Investment income (including dividends, interest, and other similar amounts) . . . ▶						
	4	Income from investment of tax-exempt bond proceeds ▶						
	5	Royalties . . . ▶						
				(i) Real	(ii) Personal			
	6a	Gross rents	6a					
	b	Less: rental expenses	6b					
	c	Rental income or (loss)	6c					
	d	Net rental income or (loss) . . . ▶						
				(i) Securities	(ii) Other			
	7a	Gross amount from sales of assets other than inventory	7a					
	b	Less: cost or other basis and sales expenses	7b					
	c	Gain or (loss)	7c					
	d	Net gain or (loss) . . . ▶						
	8a	Gross income from fundraising events (not including $ ________ of contributions reported on line 1c). See Part IV, line 18	8a					
	b	Less: direct expenses	8b					
	c	Net income or (loss) from fundraising events . . . ▶						
	9a	Gross income from gaming activities. See Part IV, line 19	9a					
	b	Less: direct expenses	9b					
	c	Net income or (loss) from gaming activities . . . ▶						
	10a	Gross sales of inventory, less returns and allowances	10a					
	b	Less: cost of goods sold	10b					
	c	Net income or (loss) from sales of inventory . . . ▶						
Miscellaneous Revenue				Business Code				
	11a							
	b							
	c							
	d	All other revenue						
	e	**Total.** Add lines 11a–11d . . . ▶						
	12	**Total revenue.** See instructions . . . ▶						

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Part IX Statement of Functional Expenses

Section 501(c)(3) and 501(c)(4) organizations must complete all columns. All other organizations must complete column (A).

Check if Schedule O contains a response or note to any line in this Part IX . . . . ☐

Do not include amounts reported on lines 6b, 7b, 8b, 9b, and 10b of Part VIII.	(A) Total expenses	(B) Program service expenses	(C) Management and general expenses	(D) Fundraising expenses
1 Grants and other assistance to domestic organizations and domestic governments. See Part IV, line 21 .				
2 Grants and other assistance to domestic individuals. See Part IV, line 22				
3 Grants and other assistance to foreign organizations, foreign governments, and foreign individuals. See Part IV, lines 15 and 16				
4 Benefits paid to or for members				
5 Compensation of current officers, directors, trustees, and key employees				
6 Compensation not included above to disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B) . .				
7 Other salaries and wages				
8 Pension plan accruals and contributions (include section 401(k) and 403(b) employer contributions)				
9 Other employee benefits				
10 Payroll taxes				
11 Fees for services (nonemployees):				
a Management				
b Legal				
c Accounting				
d Lobbying				
e Professional fundraising services. See Part IV, line 17				
f Investment management fees				
g Other. (If line 11g amount exceeds 10% of line 25, column (A), amount, list line 11g expenses on Schedule O.) .				
12 Advertising and promotion				
13 Office expenses				
14 Information technology				
15 Royalties				
16 Occupancy				
17 Travel				
18 Payments of travel or entertainment expenses for any federal, state, or local public officials				
19 Conferences, conventions, and meetings .				
20 Interest				
21 Payments to affiliates				
22 Depreciation, depletion, and amortization .				
23 Insurance				
24 Other expenses. Itemize expenses not covered above. (List miscellaneous expenses on line 24e. If line 24e amount exceeds 10% of line 25, column (A), amount, list line 24e expenses on Schedule O.)				
a				
b				
c				
d				
e All other expenses				
25 **Total functional expenses.** Add lines 1 through 24e				
26 **Joint costs.** Complete this line only if the organization reported in column (B) joint costs from a combined educational campaign and fundraising solicitation. Check here ▶ ☐ if following SOP 98-2 (ASC 958-720) . . .				

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Part X **Balance Sheet**

Check if Schedule O contains a response or note to any line in this Part X . . . . ☐

				(A) Beginning of year		(B) End of year
Assets	1	Cash—non-interest-bearing			1	
	2	Savings and temporary cash investments			2	
	3	Pledges and grants receivable, net			3	
	4	Accounts receivable, net			4	
	5	Loans and other receivables from any current or former officer, director, trustee, key employee, creator or founder, substantial contributor, or 35% controlled entity or family member of any of these persons			5	
	6	Loans and other receivables from other disqualified persons (as defined under section 4958(f)(1)), and persons described in section 4958(c)(3)(B)			6	
	7	Notes and loans receivable, net			7	
	8	Inventories for sale or use			8	
	9	Prepaid expenses and deferred charges			9	
	10a	Land, buildings, and equipment: cost or other basis. Complete Part VI of Schedule D	10a			
	b	Less: accumulated depreciation	10b		10c	
	11	Investments—publicly traded securities			11	
	12	Investments—other securities. See Part IV, line 11			12	
	13	Investments—program-related. See Part IV, line 11			13	
	14	Intangible assets			14	
	15	Other assets. See Part IV, line 11			15	
	16	**Total assets.** Add lines 1 through 15 (must equal line 33)			16	
Liabilities	17	Accounts payable and accrued expenses			17	
	18	Grants payable			18	
	19	Deferred revenue			19	
	20	Tax-exempt bond liabilities			20	
	21	Escrow or custodial account liability. Complete Part IV of Schedule D			21	
	22	Loans and other payables to any current or former officer, director, trustee, key employee, creator or founder, substantial contributor, or 35% controlled entity or family member of any of these persons			22	
	23	Secured mortgages and notes payable to unrelated third parties			23	
	24	Unsecured notes and loans payable to unrelated third parties			24	
	25	Other liabilities (including federal income tax, payables to related third parties, and other liabilities not included on lines 17–24). Complete Part X of Schedule D			25	
	26	**Total liabilities.** Add lines 17 through 25			26	
Net Assets or Fund Balances		**Organizations that follow FASB ASC 958, check here ▶ ☐ and complete lines 27, 28, 32, and 33.**				
	27	Net assets without donor restrictions			27	
	28	Net assets with donor restrictions			28	
		Organizations that do not follow FASB ASC 958, check here ▶ ☐ and complete lines 29 through 33.				
	29	Capital stock or trust principal, or current funds			29	
	30	Paid-in or capital surplus, or land, building, or equipment fund			30	
	31	Retained earnings, endowment, accumulated income, or other funds			31	
	32	Total net assets or fund balances			32	
	33	Total liabilities and net assets/fund balances			33	

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Part XI **Reconciliation of Net Assets**

Check if Schedule O contains a response or note to any line in this Part XI . . . . ☐

1	Total revenue (must equal Part VIII, column (A), line 12)	**1**	
2	Total expenses (must equal Part IX, column (A), line 25)	**2**	
3	Revenue less expenses. Subtract line 2 from line 1	**3**	
4	Net assets or fund balances at beginning of year (must equal Part X, line 32, column (A))	**4**	
5	Net unrealized gains (losses) on investments	**5**	
6	Donated services and use of facilities	**6**	
7	Investment expenses	**7**	
8	Prior period adjustments	**8**	
9	Other changes in net assets or fund balances (explain on Schedule O)	**9**	
10	Net assets or fund balances at end of year. Combine lines 3 through 9 (must equal Part X, line 32, column (B))	**10**	

Part XII **Financial Statements and Reporting**

Check if Schedule O contains a response or note to any line in this Part XII . . . . ☐

			Yes	No
1	Accounting method used to prepare the Form 990: ☐ Cash ☐ Accrual ☐ Other ________ If the organization changed its method of accounting from a prior year or checked "Other," explain on Schedule O.			
2a	Were the organization's financial statements compiled or reviewed by an independent accountant?	**2a**		
	If "Yes," check a box below to indicate whether the financial statements for the year were compiled or reviewed on a separate basis, consolidated basis, or both: ☐ Separate basis ☐ Consolidated basis ☐ Both consolidated and separate basis			
b	Were the organization's financial statements audited by an independent accountant?	**2b**		
	If "Yes," check a box below to indicate whether the financial statements for the year were audited on a separate basis, consolidated basis, or both: ☐ Separate basis ☐ Consolidated basis ☐ Both consolidated and separate basis			
c	If "Yes" to line 2a or 2b, does the organization have a committee that assumes responsibility for oversight of the audit, review, or compilation of its financial statements and selection of an independent accountant?	**2c**		
	If the organization changed either its oversight process or selection process during the tax year, explain on Schedule O.			
3a	As a result of a federal award, was the organization required to undergo an audit or audits as set forth in the Single Audit Act and OMB Circular A-133?	**3a**		
b	If "Yes," did the organization undergo the required audit or audits? If the organization did not undergo the required audit or audits, explain why on Schedule O and describe any steps taken to undergo such audits	**3b**		

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SAMPLE FORM: FUND CHARITABLE FOUNDATION ON DEATH OF BUSINESS OWNER

_____________ Charitable Foundation. After the payment of expenses and satisfaction of specific devises set forth above, which may be paid in cash or in kind, all of the rest, residue and remainder of the Trust estate, including all of my assets not passing to my said spouse by reason of the Prenuptial Agreement described above, including all limited liability companies and other entities owning interests in dry cleaners, rental companies, and residential and commercial real estate, as well as any and all entities owning interests in brokerage accounts, loans, and other assets shall be devised to the __________ CHARITABLE FOUNDATION ("___________ FOUNDATION"), which shall be established by my Trustees as an Internal Revenue Code Section 5.01(c)(3) organization, for the purpose of holding and managing the dry cleaners and related businesses, as for-profit endeavors, to help ensure that employees, suppliers, and others who have been supportive of the business and my success will have gainful employment, provided that all of such individuals shall continue to be required to work, and to earn what they receive from such companies, so that no individual directly or indirectly benefits from the general charitable organization, except as permitted under the rules which require that individuals who would benefit may not be paid more than the fair market value of the services that they render. _______________ FOUNDATION may be formed immediately after my death, or in the event of my incapacity, and may be partially funded shortly after my death, so that it can become operational and begin providing benefits for the purposes that it is being established to facilitate.

_____________________ FOUNDATION will be managed by its Trustees/Managers, who shall be _________________________, __________________, ___________________________ CPA, and they will have the power, by majority vote of those acting, to establish rules for successor trusteeship/managers, provided that ______________________ shall have the right to veto any material decision with respect thereto, and any material decision of the Trustees/Managers, so long as she is serving.

Except to the extent overridden by the acting Trustees/Managers as provided in the paragraph above, if one or more of such individuals is unable or unwilling to serve, then the remaining individuals will serve, provided that if no three (3) individuals can serve, then the remaining two individuals shall choose a licensed trust company or board certified trust and estate lawyer with at least twenty years of experience and an AV-rating in the Martindale-Hubbell Directories to serve as an additional Trustee/Manager.

I recognize that ___________________ FOUNDATION will need to operate as a school, a medical clinic, a medical research organization, or a church or other house of worship in order to be able to own business entities for more than five (5) years after my death. I therefore request that the Trustees consider establishing the ____________________________ SCHOOL OF LAUNDRY AND VOCATIONAL LEARNING, and that individuals who reside in the __________________ area have a reasonable opportunity to complete courses and obtain classroom and practical experience in all aspects of dry cleaner service management, including providing individuals who may have special needs or learning disabilities with basic skills to enable them to be employable, and to have self-esteem and fulfilling lifetimes.

I recognize that the tax law may not permit preference to be given to employees of dry cleaner's entities that are owned by _______________ FOUNDATION, but suggest that the _____________ EMPLOYEES BENEFIT TRUST being funded under Section 4.01(g) above may pay for past, present and future employees of ____________ Dry Cleaners to attend such institute on a non-discriminatory basis, so long as this would not cause disqualification or penalties to be imposed upon ____________________ FOUNDATION.

I recognize that under present tax law, the entities owned by _______________________ FOUNDATION may need to be treated as "C corporations" for federal income tax purposes, and will therefore pay state and federal income taxes on their income, and will thereafter hopefully have net additional cash that can be used for charitable and business purposes.

I request that ____________________ FOUNDATION receive at least fifty percent (50%) of the normal after-tax profits that are available, after income taxes, from the operation of the applicable dry cleaners and properties, with the other fifty percent (50%) being used to provide for growth and improvement of the businesses and properties. I request that no long-term debt or short-term third party loans will be taken on by any of the businesses or properties owned and operated under ______________________ FOUNDATION.

ABOUT THE AUTHORS

Alan S. Gassman, J.D., LL.M. is a board-certified estate planning and trust lawyer who practices in Clearwater, Florida. He has an LL.M. in taxation from the University of Florida, and practices in the areas of trust and estate planning, taxation, wealth preservation, and the representation of physicians and medical practices.

Mr. Gassman is listed as an Accredited Estate Planner by the National Association of Estate Planners & Councils, holds an AV Preeminent peer review rating with Martindale-Hubbell (based upon confidential colleague survey) which is the highest rating available, and has been included as a Florida Super Lawyer since 2006.

Mr. Gassman speaks at many tax conferences, national programs and national and local webinars, including Bloomberg BNA Tax and Accounting, the Notre Dame Tax and Estate Planning Institute, and at many other conferences and webinars.

Mr. Gassman is the lead author of *Gassman & Markham on Florida and Federal Asset Protection Law* (with Michael Markham), the electronic version of which is part of the Bloomberg BNA Tax & Accounting library, and of other books including *The Section 199A (and 1202) Handbook* (with Martin M. Shenkman and Jonathan G. Blattmachr), *Creditor Protection for Florida Physicians, Florida Law for Tax, Business and Financial Planning Advisors, What Estate Planners (And Others) Need to Know About Bankruptcy, Eight Steps to a Proper Florida Trust and Estate Plan, The Legal Guide to NFA Firearms and Gun Trusts* and several others.

Mr. Gassman has also authored or co-authored more than 250 articles for publications that include *Estates and Trusts Magazine, Estate Planning*, Bloomberg BNA *Estates, Gifts and Trusts Journal,* Leimberg Information Services ("LISI") the *Practical Lawyer,* the *Practical Tax Lawyer*, and many others.

Mr. Gassman is a regular contributor as a *Forbes* blogger, and is a primary author of the Gassman, Crotty & Denicolo *Thursday Report*, which is a free monthly newsletter for tax advisors that can be subscribed to by emailing agassman@gassmanpa.com. It is almost worth the price of subscription.

Karl Mill, Esq., is the founding attorney of Mill Law Center. Prior to founding Mill Law Center, Karl Mill was a partner at Adler & Colvin, a boutique law firm serving non-profits and their donors. Karl continues to advise a broad range of non-profit organizations, including everything from the most innovative start-ups to some of the largest, most established foundations and charities around the country.

Karl's philosophy is to apply his years as a lawyer and educator to provide clear, actionable legal advice and support to non-profits. Karl's areas of expertise include private foundations, public charities, impact investment, social enterprise, and charitable gift planning.

Karl graduated from Columbia Law School in 2013, and practiced trust, estate, and tax law for several years at DLA Piper.

Peter Farrell is a law student at Stetson University College of Law and a law clerk at Gassman, Crotty & Denicolo, P.A., in Clearwater, Florida. He graduated *summa cum laude* from the College at Brockport, State University of New York. He intends to pursue an LL.M. in Taxation and a career in estate planning.