Federal Tax Implications for the Federation and Local Clubs

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Robert F. Corrigan, Jr.

FULBRIGHT & Jaworski L.L.P.

Analytical Framework

- Basic Exemption Requirements
  - Organizational Requirements
  - Operational Requirements
  - Impermissible Inurement/Private Benefit
  - Lobbying
  - Unrelated Business Taxable Income
- Intermediate Sanctions Law
  - I.R.C. § 4958
- Specific Issues

Organizational /Operational Test

- "Corporations . . . **organized** and operated **exclusively** for [exempt] 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** . . ."
- ". . . does not **participate** in or **intervene** in . . .any **political campaign** for public office."

Unrelated Business Taxable Income

- An exempt organization may undertake activities that are **unrelated** to its exempt purpose.
- So-called unrelated business activity must be "**insubstantial**."
- Organization pays income tax on revenues from unrelated activities like other taxpayers.
- Unrelated activities must (1) constitute a **trade or business** and (2) be **regularly carried on**.

  NY Metropolitan Museum shops;
  Campus Book Store; candy sales

- **Passive income** (dividends) is not unrelated business taxable income.

Inurement/Private Benefit

The corporation may not be operated for the **benefit** of "**insiders.**" If this provision is violated, the IRS may revoke exemption.

The law doesn't prohibit benefits to non-insiders (**bad business decision**); however, when weighing all the facts surrounding the operation of the corporation, if it operates in fact **predominately** for a non-tax-exempt purpose, the IRS may revoke exemption.

American Campaign Academy v. Commissioner.

Intermediate Sanctions

- Applies to tax-exempt organizations
- In each instance, consider whether a payment is an "**excess benefit transaction**" with a "**disqualified person**" ("**insider**")
  - Example: Director or Officer
- "**Excess benefit**" is a benefit in excess of fair market value
- Consequence is imposition of **excise tax** on **recipient** and **company representative** approving arrangement

Kamehameha School Board of Trustees

Intermediate Sanctions

- *Caracci v. Commissioner* (5^{th} Cir., July 2006)

  First federal appellate case interpreting law; reflected very aggressive stance by IRS; overturned by court of appeals.

- *Dzina v. United States* (DC Ohio, 2005)

  Taxpayer sold property to charity; charity improved property which then reverted back to taxpayer, who subsequently sold for large profit. Factual dispute about amount of "excess benefit" if any.

- **Moral of the story . . .**

Intermediate Sanctions

- IRS has announced work plan for 2008; will continue focus on exempt organizations.
- Historically, emphasis was on education, not enforcement.
- With intermediate sanctions "weapon," IRS has changed focus from education to enforcement.
- Exempt organization division is now considered a revenue-generator.

Specific Issues

- Local Chapters
  - Gifts and sponsorships. What is the difference?
  - Filing Requirements, new rules applicable to chapters – postcard filing
  - Revenues from sales of hand-made items. Is it ever taxable?
  - Raffles; tax treatment of raffle proceeds
- Other Issues