From the Desk of Paul Streckfus,
Editor, EO Tax Journal

Email Update 2012-108 (Tuesday, June 26, 2012)

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1 - The *EOTJ* Mailbag (send comments to *pstreckfus@gmail.com*)

a - Comments of Bill Brockner

In response to yesterday's email update retired IRSer Bill Brockner had these comments.

One, in regard to the proposed section 501(r) regulations, here's what he had to say:

"Reverse psychology. Publication may be in anticipation of unconstitutional rejection. But it demonstrates that the reg framers are doing something (avoids criticism of dallying like with the VEBA, 501(h)/4911, (c)(7)/512 projects of the past)."

Two, in regard to Holly Pax's comments regarding IRS review of "significant diversion of assets," Bill had this comment:

"These are criminal acts. Emphasis should also be on more referrals to Criminal Investigation. On my watch, this sort of remedial action was dissuaded. It should not have been. Also, there should be referrals to the state AGs. Sections 4941 and 4958 (PF self-dealing and PC excess benefits) letters are required to be referred by law under section 6104 -- certainly, if such behavior triggers revocation notices. Criminal activity is the antithesis to the *sine qua non* of (c)(3) or (4) exemption. If illegal activity is fostered or capriciously ignored by governing boards, revocation should be mandatory, not discretionary. 'States rights' action involvement should be endorsed by the 'reds' as well as the 'blues' in these circumstances."

Three, in regard to Holly's, Lois' and Steve's excuse of "budgetary constraints" for delaying an electronic Form 1023, Bill disagreed: "I thought the converting of paper to electronic imaging was cheaper, and not only in the 'green' sense."

Four, in one of my frequent errors, I said that Holly said that “The EO function is doing a comprehensive review of the Internal Revenue Manual.” I left out that the review by EO was limited to the EO sections, expecting readers to intuit that, but Bill was on that in a flash: “The whole IRM? Not just the EO and PF Handbooks and EO operational parts? Hey, the EO function has become a Megachurch!”

Five, in regard to my observations about Denial Letter 201224034, Bill added: “Volunteer service is the heart and soul of any nonprofit. Without taking it into account, it would make exempt status standards meaningless along with such IRC provisions as dealing with ‘substantially all ... uncompensated labor.’ (Section 513(a)(1)). This is by nature and necessity ‘facts and circumstances’ analysis, in which the timing, expenses and the significance of the individual(s) participating in the focused activity(ies) are also taken into account. You need more than your calculator, abacus, or personal digits to make EO decisions. We are not bean counters. That is the burden and the beauty of working in the EO field of our chosen profession.”

b - Comments of Marc Owens

Paul, It seems to me that PLR 201224034 [discussed yesterday] was really decided on a private benefit theory -- the reference to political activity was set out as a secondary issue and the analysis pointed out that the private benefit (to the “Founder”) even carried through to the political activity. It’s interesting to note that the Emerge America group of cases was decided on the same private benefit theory (the Emerge America rulings even cited *American Campaign Academy*). To me, the cases suggest that the IRS isn’t going to spend a lot of time parsing the activities of the new group of post-*Citizens United* (c)(4)s from a political campaign intervention perspective, but rather will analyze whether a particular political party or a particular candidate is the primary beneficiary of the totality of the (c)(4)’s activities. Marc Owens, Caplin & Drysdale, Washington

My response: I have been surprised that folks are taking the Emerge America cases as reason to believe the IRS will take on the political (c)(4)s. Emerge America is, to me, simply a latter-day American Campaign Academy. For the IRS at this time to go after the political (c)(4)s, dominated by Republican stalwarts such as Karl Rove, would ignite a political firestorm and IRS Commissioner Shulman would probably join Eric Holder before House Oversight and Government Reform Committee Chairman Darrell Issa and for sure House Ways and Means Oversight Subcommittee Chairman Charles Boustany as well. See Emily Robertson’s views, to which I tend to concur [reprinted below].

Marc’s reply: I agree that Steve Miller doesn’t seem to have the stomach for confrontation with the GOP, given his actions last summer on the gift tax; I’m sure that he will have even less of an interest if Romney is elected. Of course, private versus public benefit in the (c)(4) context has been successfully litigated by the government, e.g., Vision Service Plan was a private benefit case in which the government prevailed through the 9th Circuit.

Is the IRS Going to Scrutinize Political (c)(4)s?
By Emily Robertson, Robertson Law Office, Minneapolis, Minnesota

The IRS recently revoked the section 501(c)(4) status of a state-wide affiliate of Emerge America, an organization based in California whose purpose is to identify and train women for leadership in the Democratic Party. Emerge America requires its affiliates to select a class of trainees who intend to seek public office and are registered Democrats. The organization then conducts a training program on subjects such as: campaigns and elections, fundraising, public speaking, networking, media skills, and other topics related to running for public office. Does this mean that other partisan-leaning organizations should beware?

Organizations exempt under section 501(c)(4) are also known as social welfare organizations. They are required to operate exclusively for the promotion of social welfare -- which means that they must be primarily engaged in promoting the common good and welfare of the people of a community. Implicit in this is also the requirement that the organization not serve private interests. The IRS determined that the Emerge America affiliate did not primarily promote social welfare because it primarily benefitted private individuals and interests (in this case, a political party). Educational activities that are undertaken for partisan purposes are considered to serve private interests, rather than the general welfare and common good.

Some commentators think that this could be a sign that the IRS is gearing up to target other political 501(c)(4) organizations with a partisan bent (see, for example, “IRS Denial of Tax Exemption to U.S. Political Group Spurs Alarm,” *Bloomberg News*, June 8, 2012). While I hope that turns out to be true -- I am skeptical. As a young attorney, I hate to second-guess those who I look up to as being in the top of the field (Marc Owens, for example, is cited in the *Bloomberg* article as saying “The message to groups like Crossroads [is they] need to be prepared to explain to the IRS why they’re entitled to tax-exempt status”) -- but I don’t buy it.

First, this situation is very similar to the 1989 case of *American Campaign Academy v. Commissioner*. In that case, the Tax Court upheld the refusal by the IRS to grant section 501(c)(3) status to a Republican-leaning campaign school (the fact that American Campaign Academy was applying under section 501(c)(3) is not relevant in the eyes of the IRS, as they state that the private benefit standard established in the case applies equally to both sections). The organization was found to operate for a private interest (that of the Republican party, its organizations and candidates). Unlike Emerge America, American Campaign Academy did not require its applicants to formally declare allegiance to a party -- but other factors pointed to its political leanings. There are obvious factual differences between Emerge America and American Campaign Academy; however I think that the IRS was simply addressing the fact that there is fairly analogous precedent for the argument that Emerge America should never have been granted exemption under section 501(c)(4).

Second, many of the organizations out there that are doing significant political work can easily work around the claim that they are partisan by focusing on issues (even if those issues do communicate a significant partisan leaning). Thus, they would not be subject to the same private benefit issues as Emerge America.

Third, the IRS’ recent track record on enforcing restrictions around political activities has not been good. There has been very little audit activity by the IRS in this arena -- as far as us attorneys can tell. (John Pomeranz, who I worked for at Harmon Curran in D.C. -- has made a practice of asking at ABA meetings whether anyone has a client under audit -- and nobody ever admits to it.)

I hope that I am wrong -- that the Emerge America case means that the tide is turning with the IRS -- particularly because it would require greater disclosure by organizations like Emerge America that are currently exempt under section 501(c)(4). If they have their exemptions revoked they will have to register as section 527 political organizations with the IRS. However, I don't think that the IRS has shown any inclination in recent years to address the problem.

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2 - Harmony Returns to Cato Institute?

I won't say it ended with a whimper, not a bang, but it appears the battle for the Cato Institute has apparently ended. See following article. We've discussed Cato in these pages, some may say *ad nauseum* -- in email updates 2012-40, -41, -47, -52, -53 and -54.

Now that the immediate concern is over, I believe it is time for the IRS to state in a revenue ruling that section 501(c)(3) organizations may not have shareholders nor members with ownership interests. I believe such a ban on ownership interests is inherent in the statutory requirement that an entity be organized exclusively for exempt purposes.

While the IRS is doing this, it should also specify that, in order to meet the organizational test, a board of a corporation or association must have at least five directors -- notwithstanding state laws permitting fewer, even one director -- and that none of the directors be related, except in the case of private foundations. Again, I believe such a requirement is supported by the statutory requirement that an entity be organized exclusively for exempt purposes.

Cato, Koch Brothers Settle Ownership Fight
By Kenneth P. Vogel, POLITICO, June 25, 2012

The Koch brothers and the Cato Institute have agreed to resolve their fight for control of the think tank partly by replacing Cato CEO Ed Crane, a Koch critic, with retired banker John A. Allison. The billionaire industrialists Charles and David Koch, who helped found the libertarian think tank with Crane in the 1970s and remained as shareholders, had sued to wrest control of the nonprofit group from Crane and his supporters.

Under terms of the agreement made public in a joint statement from Koch Industries and Cato Monday afternoon, the factions will end their lawsuit and dissolve the shareholder agreement. Cato will be governed by a 12-member board of directors, which initially will include David Koch and Allison, a former CEO of BB&T bank, but not Charles Koch or Crane, whose personal dispute was seen in some quarters as motivating the tug-of-war for control of the group.

Crane will retire within six months, but will work with Allison, who is serving as CEO on an interim basis, during a transition period in which a permanent CEO will be tapped. In the statement, Crane called Allison, "a great champion of liberty and an outstanding choice to build on Cato's success as the foremost non-partisan, non-aligned, independent source of libertarian perspectives on public policy."

The agreement is expected to pave the way for the Kochs -- or, at least David Koch -- to resume donating to the think tank, which stopped receiving Koch money as tensions spiked in recent years. If the settlement is finalized and the Kochs perceive it's being upheld faithfully, Cato board chairman Bob Levy told POLITICO, then "David has indicated that he will be … once again a financial supporter of the institute. So that's good news and we welcome that support." Levy stressed that financial support is not part of the agreement.

While he said the agreement, which is expected to be formally approved by the Cato board Tuesday, was enthusiastically received by Cato staff during a Monday afternoon board meeting, he conceded there was some dissatisfaction with its plan for a quick exit by Crane. "It's happening a little faster than Ed might have otherwise contemplated," Levy said. "And the Kochs wanted it to happen faster."

Levy had been among the Crane loyalists who accused the Koch brothers of trying to seize control of Cato to use it to provide "intellectual ammunition" to the network of conservative nonprofit groups funded by the brothers' donor network. The donor network, which is expected to steer as much $400 million to conservative causes ahead of the 2012 election, is gathered in San Diego for its twice-a-year fundraising summit, which is typically emceed by Kevin Gentry, a Koch operative who the brothers installed on Cato's board as they moved to seize control. But Levy pointed out that the agreement would bar Koch employees, including Gentry, from the board.

In the statement, Charles Koch expressed confidence that Allison's leadership "will enable Cato to reach new levels of effectiveness. The alarming increase in the size and scope of government is undermining freedom, opportunity and prosperity for all. Effective action is required to limit government to its proper role."

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3 - Tax Update for Churches and Religious Organizations

Tomorrow I'll have a transcript of the April 20 remarks of Deirdre Dessingue and Dan Gary, as delivered at the annual Georgetown program on "Representing and Managing Tax-Exempt Organizations." Today I'm setting out Part 2 of their outline for your reference. Part 1 appeared yesterday.

TAX UPDATE FOR CHURCHES AND RELIGIOUS ORGANIZATIONS OUTLINE (Part 2)

Submitted by:

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F. Group Ruling Issues

IRS Commissioner's Advisory Committee Recommends Retaining Group Rulings with Adjustments, but Eliminating Group Returns, Pub. 4344 (June 2011), Advisory Committee on Tax Exempt and Government Entities, Report of Recommendations, *http://www.irs.gov/pub/irs-tege/tege_act_rpt10.pdf* (p. 291). On June 15, 2011, the IRS Advisory Committee on Tax Exempt and Government Entities ("ACT") held a public meeting in Washington, DC, at which several project reports were presented. One such project, entitled *Group Exemptions – Creating a Higher Degree of Transparency, Accountability, and Responsibility*, examined current IRS group exemption procedures to evaluate their continued utility and propose changes needed to increase the transparency, accountability and responsibility of group ruling central organizations and their covered subordinate organizations.

The first official group exemption was issued by IRS in 1940, but the first formal procedures dealing with group exemptions were not issued until 1968. Prior to that time, IRS handled requests for group exemptions on a case-by-case basis without formal administrative guidance on process or requirements. The ACT undertook its group exemption project at the suggestion of IRS, which has had long-standing interest in updating its current revenue procedure on group exemptions, Rev. Proc. 80-27, now over thirty years old. In its final report, the ACT made the following recommendations:

• Eliminate group Form 990 returns by amending Treasury Regulations section 1.6033-2(d) to remove the authority of central organizations to file them. The ACT concluded that permitting group exemption holders to file group returns did not provide IRS, the states, or the public with transparency about the activities of subordinate organizations or promote accountability by individual subordinate organizations.

• Update Rev. Proc. 80-27 to provide guidance on how central organizations should exercise ongoing general supervision or control over the subordinates covered in group exemptions. Any revisions should be issued in proposed form for public comment. As part of the process, special consideration should be given to the development of appropriate standards to address the varied organizational structures and unique legal status of churches. The ACT report acknowledged that "the centralized, conventional legal or corporate model of general supervision or control simply does not work for church group exemptions." All subordinates in a church group exemption should, however, satisfy an affiliation requirement.

• Require group exemption holders that have a Form 990 filing requirement to disclose, on Schedule O of the Form 990, information about the composition of the group and how the central organization exercises general supervision or control over the group. To ensure that all groups provide this disclosure, each central organization with a Form 990 filing requirement should be required to file Form 990, even if it would otherwise be eligible to file Form 990-EZ or 990-N.

• IRS should work with section 501(c)(3) group exemption holders, including churches, to develop workable new options for including subordinate organizations in Publication 78 or otherwise providing donors with additional information regarding deductibility of contributions. While section 501(c)(3) subordinate organizations covered by group exemptions (with the exception of church group exemptions) may be listed in the Exempt Organizations Business Master File (EOBMF), they are not listed in Publication 78, making it difficult for donors to verify the eligibility of section 501(c)(3) subordinate organizations to receive tax-deductible charitable contributions. Recent IRS efforts to educate donors about their ability to rely on group exemption confirmations provided by central organizations have been only marginally successful.

• "Type III" supporting organizations under section 509(a)(3) should be ineligible for inclusion in group exemptions. This issue should be addressed as part of the project to update Rev. Proc. 80-27 and made subject to public comment.

• IRS should establish a significant transition period for existing group exemptions to come into compliance with any changes made in group exemption procedures. Special consideration should be given to existing church group exemptions, as they are some of the largest and oldest of all group exemptions. Comment should be sought from existing group exemption holders before establishing transition periods.

IRS Response. After the ACT presented its report in June 2011, IRS officials have publically questioned whether group rulings should continue, but they have also stressed the need for more information and study of this issue. Indeed, the 2012 EO Work Plan, issued early in February 2012,*http://www.irs.gov/pub/irs-tege/fy2012_eo_work_plan_2011_annrpt.pdf*,included the following item related to group rulings:

The Advisory Committee on Tax Exempt and Government Entities (ACT) issued a report on group exemptions in June 2011. EO will continue the analysis of the group exemption issue begun by the ACT by developing a questionnaire to be sent to a cross-section of group ruling holders. The questionnaire will explore the practices used by the central or parent organization to meet the requirements of Rev. Proc. 80-27, and will include questions about the methods used to satisfy annual filing requirements. In addition, based on our experience with the auto-revocation process, EO plans to expand educational efforts for group ruling members.

G. Tax Exemption Issues

IRS Denies Recognition of Exempt Status for Religious Publishing Organization. Denial 201204021 (September 1, 2011 – Released January 27, 2012). *http://www.irs.gov/pub/irs- wd/1204021.pdf.* The organization was the successor of a solely owned for-profit publishing company that converted to nonprofit status according to the vision of its founder/owner that the company “become a foundation.” The founder/owner died shortly after the formation of the nonprofit organization. In its application for exemption, the organization stated that it changed its status to nonprofit because the business had been operating “in the red.” Both the for-profit and nonprofit organizations had substantially similar names. The nonprofit organization’s articles of incorporation initially recited its purpose as engaging in any lawful business activities to promote the Christian Ministry, but this purpose was subsequently amended to read as "exclusively for charitable, religious, educational, and literacy..." purposes.

The organization’s primary activity was identified as the publication and distribution of Christian books and Bibles around the world. The publication and distribution of these books, which were printed by commercial companies throughout the United States, were designed to meet the needs of people in all areas of their lives, including spiritual, emotional, financial, and physical, on topics such as best sellers, business and leadership, Christian living, faith and healing, fiction, financial management, general interest, and social issues.

Books were priced competitively at fair market rates, and the organization’s expenditures were those typical of publishing operations, including salaries and wages, occupancy and professional fees. The organization’s assets consisted of accounts receivable and inventories; its liabilities were primarily accounts payable and notes payable. Liabilities of the for-profit predecessor organization assumed by the non-profit exceeded the value of assets transferred. Lease agreements submitted to IRS as part of the application process continued to reflect the predecessor organization as lessee.

The organization’s books were distributed through retail shops, including chain stores, as well as through domestic and foreign distributors, with some direct sales to the public. The organization utilized sales representatives and sold books at trade shows, book fairs and conventions. It also marketed books written by one of its directors and sold books published by a company owned by another director. Potential buyers were made aware of the availability of products through normal commercial avenues -- advertising, sales representatives, media, catalogues, e-mail, retailers, wholesalers, distributors and shows.

Ninety-eight percent of the organization’s income was derived from book and DVD sales, most of which were made to retailers and wholesalers around the world, with a small percentage (approximately 5% of sales) directly to individuals. In addition, the organization charged fees ranging from $50 to $200 for manuscript reviews, with some *pro bono* services provided to aspiring authors (estimated at 30%). The organization accepted donations, mainly through its website, but did not actively solicit donations. Income from gifts, grants and contributions accounted for less than two percent of the organization’s total income. A small portion of the organization’s gross receipts was dedicated to the publication of Christian literature provided free of charge to missionaries and pastors who served the poor and underprivileged. The organization also provided Bibles and other Christian literature to incarcerated individuals and people in need. The organization indicated that approximately ten percent of its publications were distributed free. The organization argued that it was distinguishable from its for-profit counterparts because it would use all profits, after repayment of debts, to fund exempt purposes.

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes.

Section 501(c)(3) regulations provide that that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals, defined to include persons having a personal and private interest in the activities of the organization.

IRS found three independent bases on which the organization failed to qualify for exemption under section 501(c)(3), any of which would independently have operated to preclude exemption: (1) The organization operated in a commercial manner; (2) the organization's operations resulted in inurement benefiting its directors; and (3) the organization's operations resulted in more than insubstantial private benefit to authors and publishing companies whose works it marketed and distributed.

IRS determined that the organization was operated in a manner similar to commercial publishing operations in terms of prices, manner of distribution, marketing, agreements with authors and other publishing companies, citing Rev. Rul. 77-4, 1977-1 C.B. 141. Like the organization described in *Better Business Bureau v. United States,* 326 U.S. 279 (1945), the organization had substantial non-exempt purposes -- commercial, inurement and private benefit -- that precluded tax-exempt status. Like the organizations described in *Scripture Press Foundation v. United States,* 285 F.2d 800 (Ct. Cl. 1961), and *Fides Publishers Association v. United States,* 263 F.Supp. 924 (N.D. Ind. 1967), the organization had the general character of a publishing house operated for profit with commercially priced inventory that catered to a religious customer base. The insubstantial percentage of inventory distributed for free did not alter the IRS analysis.

IRS cited *Foundation for Divine Meditation, Inc. v. Commissioner*, 24 T.C.M. 411 (1965), *Dominion Box Co. v. United States,* 477 F.2d 340 (4th Cir. 1973),*cert. denied,* 414 U.S. 910 (1973), *Est. of Hawaii v. Commissioner*, 71 T.C. 1067 (1979), and *Church by Mail,* 765 F.2d 1387 (9th Cir. 1985), *aff'g* TCM 1984-349, on the issues of private benefit and inurement. IRS concluded that the organization operated to benefit two of its directors, noting unfavorably the integration of operations between the organization and the operations of a director-controlled publishing company.

IRS Denies Exemption to Organization Facilitating Donations of School Supplies to Teachers. Denial 201131025 (March 3, 2011 – Released August 5, 2011), *http://www.irs.gov/pub/irs-wd/1131025.pdf.* A nonprofit membership corporation was established for the purpose of providing educational materials and classroom supplies to teachers for use in classroom instruction. The organization operated an on-line registry to enable teachers to register their needs for educational materials and supplies. Donors were able to go to the website, search for a particular teacher's registry, and select items for purchase or purchase gift certificates that teachers could redeem through the website. When an item was selected for purchase, an order was sent electronically to a specific vendor, which shipped the item, at the donor's expense, directly to the teacher at his or her school. Once an item was selected for purchase, it was automatically removed from the teacher's registry. Each registered teacher agreed that items received through the organization would be used exclusively in the classroom for the benefit of students identified in the teacher's profile and school registry, and not for personal purposes. Further, teachers agreed to return items they were unable to use.

Donors contributed amounts equal to the retail prices of the selected items, which were purchased from contracted vendors at wholesale prices. The state Parent Teacher Association promoted the organization in exchange for two percent of the organization's donations from in-state donors.

The organization's board of directors was comprised of three individuals. One director also served as the organization's president and treasurer. This director's wife served as both vice-president and secretary. The organization had one unpaid volunteer and no paid employees. It adopted a conflicts of interest policy that would be followed should the organization in the future hire employees or pay compensation.

The organization used software originally owned by a company founded by its president. The organization paid all software development costs and the company transferred all ownership rights in the software to the organization. The organization owned all trademarks, service marks, and trade names associated with this software, and had no plans to license or sell the software. Due to lack of funding during the pendency of the organization's section 501(c)(3) application with IRS, its president expended funds on behalf of the organization and the organization entered into a loan agreement to repay the principal borrowed at no interest charge.

After reviewing the organization's application and supporting documentation, IRS concluded that the organization was not conducting activities that constituted the advancement of education, as defined in the regulations to include the instruction or training of individuals and instruction of the public. Specifically, IRS concluded that by facilitating the donation, purchase and delivery of educational materials and classroom supplies to teachers who had expressed need for these items for use in their classrooms, the organization was providing commercial fundraising services to their schools, like the purchasing agency described in Rev. Rul. 54-305, 1954-2 C.B. 127, which provided purchasing services for its otherwise unrelated charitable organization members. Further, by enabling donors to donate items based on their retail price but purchasing them at wholesale prices, the organization was operating in a manner similar to a commercial enterprise carried on for profit. Accordingly, the organization did not qualify for exemption under section 501(c)(3).

H. Potpourri – Miscellaneous Developments

IRS Updates Inflation-Adjusted Figures, Rev. Proc. 2011-52, 2011-45 I.R.B. 701 (November 7, 2011). IRS released inflation-adjusted tax figures for 2012, several of which are of interest to tax-exempt organizations, including the "low cost articles" exception to unrelated business income tax under section 513(h)(2) of the Internal Revenue Code. Because of the low inflation rate, the adjustments are relatively small. For 2012, a "low cost article" is defined as one that costs the charity distributing it $9.90 or less. This figure was increased from $9.70 in 2011.

In addition, under section 170 of the Code, payments to a charity are deductible charitable contributions only to the extent they exceed the fair market value of goods or services received in return. However, certain "insubstantial benefits" may be disregarded in determining whether anything of value was received in return. Under the 2012 inflation-adjusted figures, if a donor makes a contribution of $49.50 or more to a charitable organization, low cost items (having a cost of $9.90 or less, see above) received in return may be disregarded, so that the full amount of the payment would be deductible as a charitable contribution. Likewise, if in return for a contribution, a donor receives benefits the fair market value of which is not more than 2% of the amount of payment, up to a maximum of $99, such benefits will be considered insubstantial and may be disregarded in determining deductibility under section 170. [As an interesting historical note, when these insubstantial benefit amounts were first introduced in 1990, the figures were $25, $5, and $50, respectively.]

IRS Updates Procedures, User Fee Program. IRS also updated various procedures relating to matters under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division, as follows:

Updated procedures for issuing private letter rulings, closing agreements, revenue rulings, determination, opinion, advisory and information letters, and oral advice; effective January 3, 2012. Additional language is added to section 7.04(1) regarding reinstatement of organizations that have been automatically revoked and subordinate organizations in a group ruling that have been automatically revoked. Modifications reference the requirement that Form 8940,*Request for Miscellaneous Determination*, be included with certain determination requests. The Appendix E checklist for church plan ruling requests is modified to reflect the changes in Rev. Proc. 2011-44. Rev. Proc. 2012-4, 2012-1 I.R.B. 125 (January 3, 2012).

Updated procedures for furnishing technical advice to area managers and appeals offices; effective January 3, 2012. Section 4.04 has been revised to provide that requests for abatements of more than $200,000 in all exempt organizations matters require technical advice. Rev. Proc. 2012-5, 2012-1 I.R.B. 169 (January 3, 2012).

Updated user fee schedule applicable to requests for letter rulings, determination letters, etc., effective January 3, 2011. The fee for processing Form 1023, Application for Recognition of Exemption, for organizations whose gross receipts do not exceed $10,000 is $400; the fee for all others is $850, including applications for reinstatement after revocation for failure to file Form 990 for three consecutive years. The fee for a group exemption letter remains at $3,000. The user fee for requests for reclassification of public charity/foundation status and requests for determination of section 6033 (Form 990) filing requirements is $400. The user fee for most letter rulings is $10,000. Cross references to Form 8940, *Request for Miscellaneous Determination*, have been added. Rev. Proc. 2012-8, 2012-1 I.R.B. 235 (January 3, 2012).

The annual update of procedures governing issuance of exemption determination letters and rulings under sections 501 and 521 of the Internal Revenue Code; effective January 9, 2012. These procedures also cover revocation and modification of exemption determination letters and rulings, withdrawal of exemption applications, denials of exempt status, as well as guidance with respect to exhaustion of administrative remedies prior to filing declaratory judgment actions under section 7428 of the Code. Section 4.08 is added to reflect existing practice that IRS may decline to issue a group exemption letter when appropriate in the interest of sound tax administration. Rev. Proc. 2012-9, 2012-2 I.R.B. 261 (January 9, 2012).

Updated procedures with respect to issuance of rulings and determination letters on private foundation status under section 509(a) of the Internal Revenue Code, operating foundation status under section 4942(j)(3), and exempt operating foundation status under section 4940(d)(2); effective January 9, 2012. The procedure also applies to the issuance of determination letters on the foundation status under section

509(a)(3) of nonexempt charitable trusts described in section 4947(a)(1). [Although an organization is not required to obtain a determination letter to qualify for a new public charity status, in order for IRS records to recognize any change in such status, an organization needs to obtain a new determination of public charity status under the updated procedure, to which the Rev. Proc. 2012-8 user fee for public charity status reclassification requests is applicable. Rulings concerning public charity status are open to public inspection under section 6104(a).] The 2012 procedure updates section 6.02 to reflect changes since the introduction of Form 8940 and the instructions thereto, which explain the types of requests that require the filing of Form 8940. Rev. Proc. 2012-10, 2012-2 I.R.B. 273 (January 9, 2012).

Revised IRS Publications and New Form. IRS has issued the following revised publications and a new form that may interest your organizations or clients.

Revised Publication 1771, *Charitable Contributions – Substantiation and Disclosure Requirements* (Rev. September 2011). This revised publication explains the basic IRS rules regarding deductibility of charitable contributions, as well as the recordkeeping and substantiation rules applicable to charitable contributions.

Revised Publication 557, *Tax-Exempt Status for Your Organization* (Rev. October 2011). This 80-page publication provides a comprehensive summary of the requirements for federal tax-exempt status from application through dissolution, including appeals, excise taxes, UBIT and employment tax returns, requirements for public disclosure and acknowledgment of contributions, as well as sample organizing documents. The revised publication includes new information on automatic revocation of exemption for failure to file annual information returns or notices for three consecutive years, the redesigned Form 990, elimination of the advance ruling of public charity status and elimination of Form 8734, and a new IRS future developments webpage at *www.irs.gov/pub557*. Revised Publication 557 also reminds organizations about new requirements under the Patient Protection and Affordable Care Act, electronic filing requirements for large organizations (250 returns and $10 million in assets), prohibited tax shelter transactions, and the numerous changes made for tax-exempt organizations under the Pension Protection Act of 2006.

Revised Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status* (Rev. January 2012). This revised publication describes the rights of organizations to appeal decisions of IRS about initial qualification for tax-exempt status and IRS decisions to propose revocation or modification of tax-exempt status as a result of an audit. The publication explains the appeals process beginning with protest and request for meeting and telephone conference. The Appeals Office is separate from and independent of the Exempt Organizations division. It serves as a dispute resolution forum of IRS. If an exempt organization fails to reach agreement with the Appeals Office, IRS will issue a final determination letter. Upon receipt of this letter, the organization has the right to petition the U.S. Tax Court, the U.S. District Court for the District of Columbia, or the U.S. Court of Federal Claims for a declaratory judgment as to qualification for section 501(c)(3) status, public charity status, or dispute about taxes owed.

Form 8940, *Request for Miscellaneous Determination under Section 507, 509(a), 4940, 4942, 4945, and 6033 of the Internal Revenue Code,* (Rev. June 2011). This handy one-page form may be used to request any of nine different determinations, including exemption from Form 990 filing requirements, reclassification of private foundation status under section 509(a), change in or initial determination of Type for section 509(a)(3) supporting organizations, and advance approval of voter registration activities under 4945(f) and scholarship procedures under 4945(g) [applicable to private foundations], and ruling that a potential grant qualifies as an "unusual grant" for purposes of the public support test. The 8-page instructions provide details regarding the documentation that must be submitted for each type of request. This form simplifies the process for obtaining these determinations, which in the past may have required a private letter ruling.

Note that with respect to determinations of exemption from Form 990 filing requirements, IRS has taken the position that submission of Form 8940 is not an effective means of reinstating an organization, the exemption of which has been revoked retroactively for failure to file Form 990 for three consecutive years, *e.g.*, an organization that claims not to have had a Form 990 filing obligation because it should have been classified as an integrated auxiliary of a church.

Healthcare Reform: Form W-2 Obligations to Report Costs of Employer-Provided Health Coverage. Among the numerous provisions of the Patient Protection and Affordable Healthcare Act ("ACA") was a requirement that employers report on each employee's Form W-2 the aggregate cost of that employee's employer-provided healthcare coverage, regardless of whether the employer or the employee pays for such coverage. These new reporting requirements were to have been effective beginning in 2011.

Delayed Implementation. In order to provide employers with additional time to make necessary changes to their payroll systems or procedures in preparation for the Form W-2 reporting requirement, IRS announced that reporting of aggregate healthcare coverage costs would not be mandatory for Forms W-2 issued for 2011. IRS Notice 2010-69, 2010-44 I.R.B. 576 (November 1, 2010), *Interim Relief with Respect to Form W-2 Reporting of the Cost of Coverage of Group Health Insurance Under §6051(a)(14), http://www.irs.gov/pub/irs-drop/n-2010-69.pdf.*

Transitional Relief. About a year ago, IRS issued additional interim guidance and limited transitional relief with respect to the requirement that employers report aggregate healthcare coverage costs on Form W-2. In IRS Notice 2011-28 (March 29, 2011), *Interim Guidance on Informational Reporting to Employees of the Cost of Their Group Health Insurance Coverage, http://www.irs.gov/pub/irs-drop/n-11-28.pdf*, IRS explained that Form W-2 reporting is informational only and would not affect amounts includable in income or amounts reported in any other box on Form W-2. It also clarified that the costs of dental and vision plans that are not integrated into an employer's group health plan are not subject to the Form W-2 reporting requirements, nor is Form W-2 reporting required for retired employees who may be receiving health coverage.

Two transitional relief provisions were of particular interest: (1) An employer was not required to comply with the Form W-2 reporting requirements with respect to the cost of coverage provided under a self-insured group health plan that was not subject to COBRA continuation coverage requirements, *i.e.*,coverage under a self-insured church plan; and (2) an employer who filed fewer than 250 Forms W-2 in the preceding year was not required to comply with the Form W-2 reporting requirements. The interim guidance in Notice 2011-28 is applicable beginning with Forms W-2 for 2012 and until further guidance is issued. The transitional relief will extend at least through Forms W-2 for 2012, but may be limited by future guidance. The availability of transitional relief for 2012 Forms W-2 will not be affected by the issuance of any future guidance, which will be prospective only.

Notice 2012-9, 2012-4 I.R.B. 315 (January 23, 2012), *Interim Guidance on Informational Reporting to Employees of the Cost of Group Health Insurance Coverage.* In Notice 2012-9, IRS restated and amended the interim guidance initially provided in Notice 2011-28. In response to comments, Notice 2012-9 superseded Notice 2011-28 and made changes to the guidance provided therein. Among the changes are the following:

• Modified Q/A #3 to clarify the application of the interim relief from the reporting requirement for employers filing fewer than 250 Forms W-2 for the preceding calendar year

• Modified Q/A #7 to clarify the application of the reporting requirement to certain related employers not using a common paymaster

• Added a new example to Q/A#19 that demonstrates that the reporting requirement does not apply to coverage under a health flexible spending arrangement ("FSA") if contributions occur only through employee salary reduction elections

• Modified Q/A#20 to clarify that the standard for determining whether coverage under a dental plan or vision plan is subject to the reporting requirement is based upon the standard for determining whether the coverage is subject to HIPAA rules

Notice 2012-9 provided additional guidance through new Q/A's, among them:

• Provided that employers are not required to include the cost of coverage under an employee assistance program (EAP), wellness program, or on-site medical clinic if the employer does not charge a premium with respect to that type of coverage provided under COBRA to a qualified beneficiary (Q/A#32)

• Clarified how to calculate the reportable amount for coverage only a portion of which constitutes coverage under a group health plan (Q/A#34)

• Clarified how to calculate the reportable amount if an employer is provided notice after December 31 of events that occurred on or before December 31 that affected the prior year's coverage, *e.g.*, notice of a divorce or other change in family status that occurred during a prior calendar year (Q/A#35)

• Clarified how to calculate the reportable amount where coverage extends over the payroll period including December 31 (Q/A#36)

• Provided that the reportable amount is not required to be included on a Form W-2 provided by a third-party sick pay provider (Q/A#39)

Of particular significance for churches and their affiliated entities, Notice 2012-9 retained the transitional relief for self-insured group health plans not subject to COBRA continuation coverage requirements, e.g., self-insured church plans. See Q/A#21.

Employment Tax Liabilities of Single-Member LLCs. A domestic LLC with a single member generally is disregarded for federal tax purposes unless it elects to be "regarded" separately from its member, in which case it is treated as an association that is taxable as a corporation. If the sole member of a disregarded LLC is a tax-exempt organization, the LLC is treated as a component part of its exempt single member, with information about the LLC included on the sole member's annual Form 990 filing, if required. The disregarded LLC generally receives the benefit of its member's tax-exempt status, including exemption from federal income, unemployment and other applicable taxes. However, beginning January 1, 2009, disregarded LLCs are treated as corporations for purposes of federal employment taxes. In other words, IRS may collect employment tax liabilities against a disregarded LLC as if it were a separate corporation. Information Letter 2010-0052 (March 15, 2010 – released June 25, 2010), *http://www.irs.gov/pub/irs-wd/10-0052.pdf*.*See also,* IRS Publication 3402, *Tax Issues for Limited Liability Companies* (Rev. March 2010), *http://www.irs.gov/pub/irs-pdf/p3402.pdf*.

Late last year, IRS issued temporary regulations that extended the religious exception from taxes under the Federal Insurance Contributions Act ("FICA") under section 3127 of the Code [for employers and employees where both are members of religious faiths opposed to participation in social security act programs] to entities, like single member LLCs, that are disregarded entities for federal tax purposes. These entities, which are treated as corporations for employment tax purposes, may qualify for the exception noted by treating the owner of the disregarded entity, *i.e.,* the single member, as the employer. T.D. 9554, *Notice of Proposed Rulemaking by Cross- Reference to Temporary Regulations, Extending Religious and Family Member FICA and FUTA Exceptions to Disregarded Entities,* REG-136565-09, 2011-50 I.R.B. 851 (December 12, 2011).

Update on ECFA Commission. The ECFA (Evangelical Council for Financial Accountability) Commission on Accountability and Policy for Religious Organizations was formed early in 2011 in the wake of the Senate Finance Committee staff report outlining a three-year inquiry into the financial practices of six media-based Christian ministries. The Commission agreed to undertake the task of reviewing and providing input on major accountability and policy issues affecting churches and religious organizations, primarily as outlined in the staff report. The Commission has met during the interim and has received input from its three panels -- an advisory panel of religious sector representatives, a legal advisory panel and a nonprofit sector advisory panel. In addition, the Commission has established a webpage within the ECFA website whereby interested members of the public can provide input on enumerated issues.

Issues under consideration by the Commission include the following: Should churches be more accountable to the federal government through the filing of Form 990 or otherwise; is legislation needed to curb perceived abuses of the section 107 clergy housing allowance exclusion; should the current prohibition against political campaign intervention by churches and other charities be repealed or modified; should the rules for determining the reasonableness of nonprofit executive compensation be tightened; and should penalties be expanded for charities and their leaders who engage in prohibited activities?

The public comment portion of the Commission's website will be available through March 31, 2012 at *www.religiouspolicycommission.org/Publicinput.aspx*. The Commission expects to issue a report outlining its recommendations to Senator Grassley later this year.

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