



NONPROFIT ORGANIZATIONS COMMITTEE NEWSLETTER

Second Quarter, 2017

[Homepage](#) | [Committee Roster](#) | [Join the Nonprofit Organizations Committee](#)

In This Issue

[Message from the Chair](#)

[Program: Nonprofit Associations: Being Unincorporated in the Twenty-First Century Nonprofit Organizations](#)

[Social Entrepreneurship and Social Benefit Entities Subcommittee](#)

[Canada Report: NPOs: Courts Continue to Show More Flexibility than the CRA](#)

[Outstanding Nonprofit Lawyer Awards](#)

[National Updates - July 2017](#)

Important Dates

[Business Law Section Annual Meeting](#)

September 14-16, 2017
Chicago, IL

Editorial Board

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Message from the Chair

I write this message while enjoying the glow that the setting sun creates on the leaves of the tree outside the porch. Summers allow us to slow down and spend some time enjoying and reflecting on what has come and what is to come. I hope that many of you have an opportunity to do that in August.

One of the things our committee has been spending some time thinking about is who plays a supervisory role within the charitable sector. Many practitioners in our sector are largely focused on the IRS and its role in regulating our clients. However, with cuts to its budget and the legacy of the targeting allegations, it may be that the IRS will play a less significant role in the near future. The program we will be hosting at the Business Law Annual Meeting in Chicago this September will be entitled "Time for a New Regime? The Future of Charities Regulation". We will look at the other ways that the charities can be regulated, with a panel composed of those with experience in what Attorney Generals can do, what self-regulation could and does look like and something that the United States and Canada do not have, a separate Charities Commission. Our speakers will share not only a North American perspective but will include an insider's experience in both the British and Australian Charities Commissions. While the British Charities Commission has a storied history, the Australian Charities and Not-For-Profit Commission is a relatively recent (2012) innovation and will be an interesting example of how at least one country has attempted to implement with a more comprehensive regulatory scheme. With the participation of advocates of self-regulation, this Continuing Legal Education Program promises vigorous discussion. I would note that this program is scheduled for 8:00 a.m. Thursday September 14, which is an earlier CLE Program slot than our Committee usually receives so please make your travel arrangements with that in mind.

The drafting of a revised Model Nonprofit Corporations Act is well underway and the drafting committee is meeting on Wednesday September 13, 2017 in Chicago during the Business Law Annual Meeting. Members of the Committee should have received details of that meeting. Please contact either Lawrence Beaser (Chair) or William Clarke (Recording Secretary) for more details if needed. On behalf of the Committee, I want to thank Bill Clarke's firm for hosting that meeting at their offices.

The rest of our Committee's activities are clustered on the Friday and Saturday, September 15 and 16. The meeting is in Chicago at the Grand Sheraton and details, registration and hotel booking information can be found here: https://www.americanbar.org/groups/business_law/events_cle/annual_2017.html. I encourage you to register and book now.

Please also remember that you can attend our meetings (but not the Program) by teleconference. We want your participation. Attending our meetings are the best way for you to become involved (and to volunteer to help out with opportunities and initiatives which are raised, often unexpectedly, at the meetings) and that is possible to do on the telephone. I will be circulating the finalized list of meeting times and the teleconference number once it is finalized over the list serve.

For those of you who can attend in person, the meeting is a time to get to know other practitioners in our sector better. We have practitioners come regularly from Hawaii and every other corner of the United States. You can finally put faces to

the postings on the list serve. It allows us to network, find expertise in other jurisdictions and soak up some of the excitement that is only generated when a group of nonprofit law practitioners from all over get together.

While one of the highlights of our meeting, the Current Affairs Discussion, can be participated in over the telephone, it is impossible to enjoy our Committee Dinner unless you come. Our Committee Dinner will be held on the evening of Friday, September 15. I will be circulating details once a reservation is made through the list serve, so please keep an eye out for that. Our Committee has a tradition of welcoming spouses and others to our dinners, so please feel free to invite them. It would be helpful if you would advise my assistant, Linda Lau, whether (and how many) you intend to come so we can make reservations. She can be reached at llau@millertomson.com

This meeting will also be my last meeting as your Committee chair and I look forward to having William Klimon lead our Committee to better things.

I look forward to seeing you at the meeting.

Respectfully,

David Tang



Program: Nonprofit Associations: Being Unincorporated in the Twenty-First Century Nonprofit Organizations

At the ABA Business Law Section Spring Meeting in New Orleans in April, the Nonprofit Organizations Committee sponsored a panel on unincorporated associations.

The panel included:

- William Klimon, Caplin & Drysdale, Washington, DC
- Lisa Runquist, Northridge, CA
- Philip Hackney, LSU Law, Louisiana, LA

An unincorporated association is two or more persons joined together for a common purpose; an unincorporated nonprofit association operates for a nonprofit purpose. Many organizations operate as unincorporated associations, including certain churches and political organizations, some chapters of national organizations, and, until 1992, the American Bar Association. This panel discussed how unincorporated associations are formed (whether intentionally or not), distinguished unincorporated associations from partnerships, and considered advantages and disadvantages of being unincorporated. The panel explored questions such as can an unincorporated association sue or be sued or enter into contracts, are members shielded from personal liability, and can they own property. The panel also discussed the status of the Uniform Unincorporated Nonprofit Associations Act.

All of the meeting materials, including materials for this panel, have been posted online and are available to Business Law Section members. To access the materials, login through your ABA membership and see the Spring Meeting website.

Social Entrepreneurship and Social Benefit Entities Subcommittee

The Subcommittee on Social Entrepreneurship and Social Benefit Entities explores the role of for-profit and nonprofit enterprises in furthering social entrepreneurship and the laws and policies that encourage and facilitate the growth of socially responsible companies.

At the Committee's April meeting in New Orleans, practitioners discussed their experience with respect to why entrepreneurs are adopting the benefit corporation form, in which states they are forming benefit corporations, and the role of equity crowdfunding for social enterprises. Benefit LLCs also were discussed, which are coming online in a number of states and provide the option of a flow-through partnership tax structure.

In addition, the Subcommittee reviewed IRS Information Letter 2016-0063. In this Notice, the IRS has clarified that a benefit corporation may deduct certain payments to charity as a fully deductible business expense for institutional or goodwill advertising rather than as a charitable contribution subject to a 10% limitation on corporate donations.

The Subcommittee is organizing a task force to provide guidance and recommendations on benefit corporation reporting, which may include examples and forms for practitioners to use. If you work with benefit corporations and would like to participate in this project or contribute reporting examples, please contact David Levitt at levitt@adlercolvin.com.

Canada Report: NPOs: Courts Continue to Show More Flexibility than the CRA

By Daniel Frajman

Canadian non-profit organizations (paragraph 149(1)(l) of the Canadian Income Tax Act) are facing regulatory difficulties with the Canada Revenue Agency which are in some ways more difficult than the regulations faced by Canadian registered charities (section 149 the Canadian Income Tax Act). Both Canadian non-profit organizations and Canadian registered charities do not pay income tax, but only Canadian registered charities can issue tax receipts for donations. The attached article deals with some of the regulatory difficulties being faced by the Canadian non-profit organizations.

This article, by Montreal attorney Daniel Frajman, of the firm Spiegel Sohmer Attorneys, first appeared in the Canadian Not-For-Profit News of April 2017 and The Canadian Taxpayer of February 24, 2017, which are edited by Arthur B.C. Drache, C.M., Q.C.. Reproduced by permission of Thomson Reuters Canada Limited.

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Outstanding Nonprofit Lawyer Awards

The Committee has announced its 2017 Outstanding Nonprofit Lawyer Award recipients. The Outstanding Nonprofit Lawyer awards are given annually to attorneys who have made outstanding contributions to the nonprofit sector and/or the development of nonprofit law. Congratulations to all recipients:

Vanguard Award for distinguished lifetime achievement in the nonprofit sector: **Jeffery L. Yablon**, Partner, Pillsbury Winthrop Shaw Pittman LLP

Outstanding Academic Award for distinguished academic achievement in the nonprofit sector: **Alicia Plerhoples**, Associate Professor of Law, Georgetown University Law Center

Outstanding Lawyer Award for distinguished service as outside counsel to nonprofit organizations: **Thomas K. Hyatt**, Partner, Dentons

Outstanding In-House Counsel Award for distinguished service by a nonprofit in-house counsel: **Faith Thomas**, Senior Vice President and General Counsel, Enterprise Community Partners, Inc.

Outstanding Young Lawyer Award for distinguished service by an attorney in the nonprofit sector who is under the age of 35 or has been in practice less than 10 years: **Celeste E. Arduino**, Member, Bodman

National Updates - July 2017

IRS Makes 1023-EZ Application Information Available

On February 22, 2017, the Internal Revenue Service made publicly available information from approved applications for tax exemption using Form 1023-EZ, Streamlined Application for Recognition of Exemption. The data is available at the IRS website, which states that the information is updated quarterly. The information available includes the organization's name and address, employer identification number, names of officers, directors, and trustees, primary contact name and phone number, and the organization's website.

Court of Appeals Applies Corporate Overpayment Interest Rate to Nonprofits

On April 25, 2017, the Court of Appeals for the Seventh Circuit affirmed a district court ruling that the interest rate the Internal Revenue Service is required to pay with respect to tax overpayments by corporations applies to overpayments by nonprofit corporations. The Second and Sixth Circuits have previously ruled the same. The corporate overpayment rate is a lower rate than that which applies to overpayments by non-corporate taxpayers. The nonprofit, tax-exempt entity in the case, Medical College of Wisconsin Affiliate Hospitals, Inc., overpaid approximately \$14 million in the employer's share of FICA tax, plus \$13 million in interest on that tax, which the IRS refunded to the organization. Subsequently, the IRS demanded repayment of approximately \$6.7 million (the difference between the statutory interest rates for a corporation versus a non-corporate taxpayer), stating that it had overpaid the interest refunded. The organization repaid the interest and claimed a refund. Both the district court and the Seventh Circuit held that the lower interest rate applied. See *Medical College of Wisconsin Affiliated Hospitals, Inc. v. U.S.*, 854 F.3d 930 (7th Cir. 2017).

Executive Order on Johnson Amendment

On May 3, 2017, the President signed an Executive Order on "Free Speech and Religious Liberty". Section 2 of the Order is aimed at the "Johnson Amendment" prohibiting partisan political activity by organizations exempt from federal income tax as organizations described in Section 501(c)(3) of the Internal Revenue Code.

The Order prohibits the Treasury Department from taking "any adverse action against any individual, house of worship, or other religious organization on the basis that such individual or organization speaks or has spoken about moral or political issues from a religious perspective, where speech of similar character has, consistent with law, not ordinarily been treated as participation or intervention in a political campaign on behalf of (or in opposition to) a candidate for public office by the Department of Treasury." An adverse action is defined as "the imposition of any tax or tax penalty, the delay or denial of tax-exempt status, the disallowance of tax deductions for contributions made to [Section 501(c)(3) organizations], or any other action that denies or makes unavailable any tax deduction, exemption, credit, or benefit."

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But what about one of the most common issues, alleged lack of control over assets which have been entrusted to an agent abroad. As most readers are aware, the vast majority of charities doing work abroad do so through the use of agency agreements. And one needs only to look at some of the decided cases to see that there can be great differences of opinion as to whether the arrangements meet the CRA standards. Of course, when the issue is litigated, the CRA always wins, given the deference shown to it by the Federal Court of Appeal.

In virtually every case we have seen and litigated, the directors believed they were acting in good faith and following the CRA's guidance, only to be told *ex post facto* that they were wrong. This often results in a revocation.

Do the directors become "ineligible"? Is the failure of an agency agreement "serious"? The fact of the matter is that if one reads the guidance, it is clear that the Charities Directorate may or may not deem a director to have become "ineligible". And that vagueness is what is bothersome.

We have recently seen a case where a new director of a small charity who had not been involved in setting up the agency agreement or being "hands on" enough to know whether it was being adhered to, found himself in a situation where the organization was about to have its registration revoked.

There won't be an appeal of the revocation. But the individual is also the member of several other boards, all of them fairly large and very public. If he is deemed to be "ineligible" because of the revocation of the one small charity, will the other charities get letters from the CRA telling them that he is ineligible? If this happens, an active volunteer and donor will be hugely embarrassed in front of his peers.

But there is no way, until the CRA indicates the position it will take, for him (or his legal advisers) to make a judgment as to whether his status is at risk. Perhaps the prudent thing for him to do is quietly resign from all his boards as a precaution and to preserve his reputation. If he does so, the community has sustained a significant loss.

It seems to us that more thought should be given to how situations where there is no breach of the law or moral lapses, can be better handled. Unfortunately, that is not likely to happen.

NPOs: Courts Continue to Show More Flexibility than the CRA

Daniel Frajman

Top of mind for many is whether the government will soon be making changes to the legislative framework for non-profit organizations (NPOs). Such changes may be premature, given that the government's promised consultation on NPOs does not

appear to have been completed. However, if change does come, it will hopefully take account of court decisions in the area, both at the federal and provincial level, that have shown more flexibility towards NPOs than the CRA in its interpretations. We will below briefly refer to the consultation and the interpretations, and to two of the major court decisions, including the recent decision of the Court of Quebec, *Coop publicitaire des concessionnaires Chrysler Jeep Dodge du Québec v. Agence du revenu du Québec* ("Coop").¹

Since at least 2009,² the CRA has issued several technical interpretations and statements showing a narrow interpretation of activity that is acceptable for an NPO. The legislative definition of an NPO, essentially unchanged since 1917, is at [paragraph 149\(1\)\(l\)](#) of the *Income Tax Act* (Canada), indicating in essence that (i) an NPO must be operated "for any purpose except profit", and (ii) none of the NPO's income may be payable to or otherwise available for the personal benefit of any proprietor, member or shareholder of the NPO. Most of the CRA's recent interpretations have focused on the first of said criteria, i.e., whether the organization operates for a profit purpose.

The CRA's recent positions seem narrow in that they essentially say that if an NPO earns profit, the profit should be unanticipated and incidental, possibly that whether profit is earned is evaluated on a project by project (or division by division) basis rather than by looking at all of the organization's operations together, that activities would normally be carried out on a cost-recovery basis and that unreasonably high accumulated surpluses are to be avoided.

In the 2014 federal budget, the government announced a public consultation on the income tax framework and reporting requirements for NPOs (not charities). A few days later, the CRA released a short report titled, "Non-Profit Organization Risk Identification Project", which essentially indicated that the CRA had reviewed over 1,300 NPOs over the previous three years to research tax compliance in the non-profit sector, a significant number of such organizations would in the CRA's view fail to meet at least one of the requirements for being an NPO, the CRA would work to improve NPOs' understanding of their obligations through outreach, client service and education, and "because... the legislative framework may benefit from further examination, a copy of this report will be provided to the Department of Finance Canada for information and consideration". To date there has been to our knowledge no consultation process and report thereon on the framework for NPOs, and no legislative proposals.

As regards greater flexibility in the courts, we look first at the Tax Court of Canada's 2008 decision in *BBM Canada v. The Queen* ("BBM").³ *BBM* concerned an organization assembling survey data relating to radio and television listening and viewing habits, with the surveys made available to its members, being both public

1 2016 QCCQ 11252, 2016 CarswellQue 9576.

2 CRA Views 2009-0337311E5, "149(1)(l) organizations", November 5, 2009.

3 2008 TCC 341, 2008 CarswellNat 1844, [2009] 1 C.T.C. 2117.

and private broadcasters. The Court found the BBM organization to be operating for a purpose other than profit, and to therefore be an NPO. It appears instructive to quote the following from Justice Boyle's decision in *BBM*:

[46] It has long been CRA's view, published in [Interpretation Bulletin IT-496 "Non-Profit Organization"](#), that some things, such as the realization of significant profits or the accumulation of unreasonable reserves can be evidence of an unstated profit purpose. Other relevant considerations set out in the Bulletin are whether the entity's activities are operated in a normal commercial manner, whether goods and services are sold to non-members, whether it is operated on a profit basis rather than a cost recovery basis and whether it operates in competition with taxable entities carrying on the same trade or business. I agree that, in appropriate cases, these may be reasonable and relevant considerations, though they cannot all be requirements, they must be weighed appropriately in the circumstances of each case, and none will be determinative. However, in this case their consideration does not lead me to conclude BBM has an unstated profit purpose.

[47] The Crown has conceded BBM's reserves over the years were reasonable in amount relative to the needs of their operations.

[48] BBM operates on a cost recovery basis over the medium and long term even though it does not operate on a cost recovery basis each year. If its reserves are reasonable in relation to its needs, this means the reserves will be spent within a reasonable period.

[49] If its reserves are reasonable and it operates on a cost recovery basis, it would be hard to say an organization realizes significant profits.

[50] BBM only sells its data to its members. It would be difficult to impute a profit purpose to an organization that only sells to members on a cost recovery basis...

[52] Caution needs to be taken with the Bulletin's consideration of whether the operations are operated in a normal commercial manner...With respect, that is not what I would consider sufficient to put an organization offside...It is the public sector, governments and quasi-governments, and the non-profit and charitable sectors that need to be reminded they should be business-like in their operations and delivery of services.

[53] [Rather, the] operations of not-for-profit entities like BBM lack a significant attribute of commercial businesses. There is no opportunity for their shareholders, members or controlling persons to benefit financially by way of profits, distributions, unrestricted salaries, capital appreciation of the undertaking or its assets, or in similar fashion.

BBM also refers to a proper way of effecting a change in the law, as follows (at paragraph 41):

If a revision [to the law] is needed it should be left to a possible legislative change which would only be done after a review of the need for such a change was done by persons responsible for tax policy, aware of the depth and breadth of the sector..., aware of all of the fiscal impacts beyond the application of paragraph 149(1)(l) of the *Income Tax Act*, and which would allow for the possibility of

consultation. Canadians, Canadian society, the provinces and the non-profit sector deserve as much.

The recent *Coop* case applies and approves *BBM*. The NPO co-operative in *Coop* provided promotion and publicity services to its members (certain automobile dealers in Quebec), with each member contributing funding to the co-op based on the number of vehicles purchased from the automobile manufacturer. The Court of Quebec was considering sections 986 and 996 of the *Taxation Act* (Quebec), which are essentially identical to paragraph 149(1)(l) of the *Income Tax Act*. The Court held that the co-op was an NPO, and stated as follows:

- the co-op is seeking to recover its costs; an annual operating surplus is used to finance the next year's activities;
- the co-op's funds are not distributed to its members as profits or rebates;
- the legal situation of the co-op is analogous to that of *BBM*; the CRA's position in *BBM* was dismissed and the *Coop* case does not justify a different decision;
- it is permissible for the co-op to file as a non-profit in the year in question, and not as a non-profit in other years.

Therefore, the courts are following a wider view as to what is an NPO, as compared to administrative positions of the tax departments, and the tax departments should be following the lead of the courts. For its part, Finance's consultation on the legislative framework for NPOs does not appear to be complete, so legislative change, especially if it is aimed at overturning the position of the courts, seems to be premature.

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Publicizing Massive Gifts: Potential Pitfalls

A few months ago we attended a seminar for directors of museums and galleries sponsored by the Canadian Museums Association. Over lunch at our table, the conversation turned to the topic of some of the huge gifts which had been made to Canadian institutions (not just museums) in the past year or two.

The talk was triggered by a full page ad in the *Globe and Mail* publicizing one such gift to the National Arts Centre in Ottawa.

The question was raised as to whether such publicity was counter-productive.

Given the attendees at the seminar, everyone agreed that working to get such gifts was a key goal of all fundraisers. And they all agreed that if the donors agree, it was great publicity for the organization to let the public know that this level of support had been given...particularly when the gift was not tied to a specific