



# NONPROFIT ORGANIZATIONS COMMITTEE NEWSLETTER

Second Quarter, 2018

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## Important Dates

[Business Law Section Annual Meeting](#)

September 13-15, 2017  
Austin, TX

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## Editorial Board

**Emily Chan**, San Francisco, CA  
**Matthew G. Wright**, Waco, TX

## Message from the Chair

Greetings from Washington, D.C. We had a great meeting in April in Orlando, Florida, and we're busy preparing for our annual meeting in Austin, Texas, to be held September 13 to 15. We're looking forward to CLE programs on two very timely topics: healthcare joint ventures and board transitions. If you can, I strongly encourage you to register and attend the meeting. As usual, we'll have programs with excellent content, camaraderie and news you can use, and some great food (in this instance, I'm anticipating some really good barbecue). So please join us.

On the theme of joining in, I want to mention two other developments: First, in line with recent initiatives of the Business Section, I have formed a membership subcommittee and appointed our recent member Jacob Dean as chairman. Jacob has a long-term interest in nonprofit organizations, clerked on the U.S. Tax Court, and is currently an associate with Critchfield, Critchfield & Johnston in Wooster, Ohio. He's also a people person, so if you have prospects for new members for the Nonprofit Organizations Committee, please contact Jacob and he'll follow up with them (e-mail: [dean@ccj.com](mailto:dean@ccj.com)).

Second, the Business Section is exploring launching a new leadership program that would be aimed at young lawyers, that would involve substantive training at the Section's meetings (and possibly at other times), and that will result in a certification. The Section is looking to the Nonprofit Organizations Committee to provide some significant content for this program. More information to come on that front.

Cheers, and hope to see you all soon.

Bill Klimon, Chairman



## A Quick Note on For-Profit College Conversions

*By: Samuel D. Brunson, Georgia Reithal Professor of Law, Loyola University Chicago School of Law*

At the beginning of 2018, a number of Democratic Senators wrote to the Department of Education's National Advisory Committee on Institutional Quality and Integrity. The Senators were concerned about the recent spate of for-profit colleges converting (or, at least, attempting to convert) to nonprofit colleges. And

the volume of conversions seems to be increasing as the for-profit colleges suffer from declining enrollments and poor public image. Most recently, in March, Bridgepoint Education announced a merger of its University of the Rockies and Ashford University. Ashford University, as the surviving entity, intends to convert into a nonprofit.

The conversion of for-profit colleges into nonprofits is not necessarily insidious, of course. Nonprofit colleges may have a reputational advantage that formerly for-profit universities would like to enjoy. A school may outgrow its original mandate, or its founders' ability to manage it.

But schools may also have bad reasons for wanting to convert. While the Trump administration has frozen Obama-era regulations applicable to for-profit colleges, conversion may still allow them to fall into a regulatory black box, as they get out of federal regulation, and the IRS begins to exercise the primary federal oversight.

Moreover, the former owners of the converted colleges may continue to enjoy financial benefits, as they lease facilities to the converted colleges and provide management services to them.

## Canada Report: Utility Vehicle: Worldwide Use of Canadian Charitable Foundations

*By: Daniel Frajman*

This article examines the main features of the Canadian charitable foundation structure: tax-free status; issuer of Canadian tax receipts; requirement to have charitable purposes and activities as established at common law; an ability to have assets deposited and activities carried out internationally; requirement to have direction and control over activities, helping to avoid "vanity charities"; directors may not have to be Canadian, as the required Canadian residency for the foundation is satisfied by incorporation in Canada; and the ability for the founder to keep control if donations are not solicited from the public. These features can make the Canadian charitable foundation attractive. In addition, American charities should be aware that a Canadian charitable foundation (or charitable organization), often called a Canadian Friends Organization, is usually required in order to provide tax relief to Canadians donating funds for charitable work in the US.

*This article, by Montreal attorney Daniel Frajman, of the firm Spiegel Sohmer Attorneys, was first published in the STEP Journal, Volume 26, Issue 4.*

[Read more...](#)

## National Updates - June 2018

*Meghan R. Biss, Caplin & Drysdale, Washington, D.C.*

### **Notice Released Regarding the Excise Tax Applicable to Certain Private Colleges and Universities**

On June 8, 2018 the IRS released an advanced version of [Notice 2018-55](#), announcing it intends to issue proposed regulations clarifying the calculation of net investment income for purposes of the excise tax under section 4968. Section 4968 imposes an excise tax equal to 1.4% of the net investment income of private colleges and universities with at least 500 full-time tuition paying students (more than 50% of which are located in the United States) and an endowment of at least \$500,000 per student.

Section 3 of the notice provides that in determining gain or loss from the sale of assets, the basis of assets is generally the fair market value of those assets as of December 31, 2017. Organizations should apply rules similar to those contained in the regulations for section 4940(c) to determine the gain or loss. Until further guidance is issued, organizations will have reliance on this section. The notice also request written comments by September 6, 2018.

### **Updated Guidance on Grantor and Donor Reliance**

The IRS recently released [Revenue Procedure 2018-32](#), which explains when grantors and contributors may rely on the listing of an organization IRS databases of organizations eligible to receive tax-deductible contributions under section 170. The Revenue Procedure also provides safe harbors for determining unusual grants.

Additionally, the Revenue Procedure reflects the change from the use of Select Check to a new database, Tax Exempt Organization Search. This system includes information on whether an organization is a supporting organization described in section 509(a)(3) and whether the organization is a Type III non-functionally integrated supporting organization. It also contains copies of determination letters issued after January 1, 2014.

Notably, the Revenue Procedure eliminates reliance for subordinates in a group ruling regardless of whether the subordinate organization appears in the EO Business Master File Extract. Rather, grantors and contributors are directed to consult the official subordinate listing approved by the listed central organization or contact the central organization directly.

### **New Revenue Procedure Makes it Easier for Exempt Organizations to Restructure**

In February the IRS released [Revenue Procedure 2018-15](#), which makes it easier for organizations to restructure. At least since the 1960s, exempt organizations could not carry over the benefit of IRS recognition to a newly reorganized entity and were often not permitted to retain their EIN when they engaged in restructuring activities. Over time, the IRS eased the rules to allow retention of the original EIN in most cases, while still requiring that these organizations submit new applications for recognition of tax-exempt status.

In Revenue Procedure 2018-15, the IRS has removed the exemption-related obstacles to corporate restructuring, as it now simply requires that organizations report these changes on their Form 990 and also provide notice of any change in address-instead of submitting a new Form 1023 for reorganizing 501(c)(3) organizations or Form 8976 for reorganizing 501(c)(4) organizations.

These new rules only apply in specific situations. The reorganized entity must carry out the same exempt purposes under the same paragraph of 501(c) as the organization that engaged in the restructuring. Additionally, if the organization is a 501(c)(3) organization, the new articles of incorporation must continue to meet the organizational test, including the dedication of assets for charitable purposes. The new guidance does not apply where the surviving organization is a disregarded entity, LLC, partnership, or foreign business entity. It does not apply to tax-exempt trusts that decide to incorporate or to organizations that merge into LLCs or disregarded entities. Finally, if the surviving organization does obtain a new EIN, it will be required to submit a new application.

### **IRS Releases TE/GE Accomplishments**

In March 2018, the IRS released the accomplishments for the [Tax Exempt and Government Entities Division for Fiscal Year 2017 \(FY 2017\)](#). For FY 2017, the IRS completed 6,101 examinations of exempt organizations and revoked the exempt status of 63 organizations. The IRS has also continued to rely upon its

data driven methodology for examinations. For FY 2017, the IRS closed 1,505 exempt organization returns that were selected through this process. The change rate on those cases was 83%, which is indicative of the data-driven methodology correctly selecting returns that are at a higher risk of non-compliance with the tax law. The IRS also continues to focus implementing the requirements of the Patient Protection and Affordable Care Act (which requires the IRS to review hospitals for compliance with section 501(r)). For FY 2017, the IRS completed 1,193 reviews under section 501(r) and referred 388 hospitals for field examination.

### **Changes to IRS Forms & Instructions for 2018**

For 2018, the IRS made changes to several application forms. The Form 1023 underwent minor revisions by adding in a new foundation classification (170(b)(1)(A)(ix) for agricultural research organizations), eliminating outdated language on the advanced ruling period for public charity status, and modifying Schedule E regarding organizations requesting status under section 501(c)(4) if they are applying more than 27 months after formation. The IRS also made several changes to the Instructions for the Form 1023.

The IRS created a new Form 1024-A, *Application for Recognition of Exemption under Section 501(c)(4) of the Internal Revenue Code*. This form was created in response to language contained in the Technical Explanation of the Revenue Provisions of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40), (JCX-144-15), December 17, 2015. The development of this form also necessitated changes to the Form 1024 to remove references to section 501(c)(4) organizations.

Finally, as the IRS works to implement the changes from Public Law 115-97, additional changes to forms, instructions, and publications should be expected. Forms that could be updated include the Form 990, Form 990-T, and Form 4720. Additionally, the IRS has released a new Form 990 W, which is the form organizations use to make estimated tax payments.

## **Business Law Section Annual Meeting in Austin, TX: September 2018**

The Nonprofit Organizations Committee will meet at the Business Law Section's Annual Meeting in Austin, Texas, this September 13-15. Registration information and the full meeting schedule can be found [here](#).

## **Article Writers Wanted**

The Newsletter Editorial Board is seeking articles on nonprofit law subject matter to include in future newsletters. There is no length requirement. If you are interested in submitting an article, please contact:

- Emily Chan at [echan@adlercolvin.com](mailto:echan@adlercolvin.com) or
- Matthew Wright at [matthew@diazwright.com](mailto:matthew@diazwright.com)



## UTILITY VEHICLE

Daniel Frajman explains how philanthropists across the world can make use of Canadian charitable foundations

### ➤ KEY POINTS

#### WHAT IS THE ISSUE?

Persons interested in philanthropy may not have a vehicle practical for carrying out charitable works in their home jurisdiction. They should consider forming a Canadian private foundation, which can usually operate worldwide.

#### WHAT DOES IT MEAN FOR ME?

Philanthropists, including non-Canadians, can likely establish and control a Canadian private foundation.

#### WHAT CAN I TAKE AWAY?

A Canadian private foundation is set up under recognised and monitored rules, and can be a secure vehicle for a charitable endowment.

PHILANTHROPISTS IN SOME parts of the world may find themselves in a quandary. Although they would like to set aside funds clearly marked for a charitable use in their country of residence (Home Country), the Home Country lacks legislation or practice allowing this to be easily done.<sup>1</sup> A solution may be to establish a charitable foundation in Canada, which will be able to carry out charitable works in the Home Country. This article contains a creative review of the features of the Canadian charitable foundation (particularly the private foundation) and so demonstrates how this solution may be carried out.

#### REGISTERED CANADIAN CHARITIES

The Canadian federal *Income Tax Act* (ITA)<sup>2</sup> sets out rules for establishing charities.<sup>3</sup> Those rules are expanded on in published guidance issued by the Canada Revenue Agency (CRA), by case law, and by federal and provincial rules mostly relating to the formation of corporations and trusts. Some of the principal rules are as follows:

- Canadian charities can carry out their charitable works anywhere in the world, without a requirement to do so in Canada.
- A Canadian charity is first established as an organisation, usually a non-share capital corporation (with members, who

appoint a board of directors that manages the corporation and can appoint officers), or sometimes a charitable trust. Perhaps because third parties are receptive to working with corporations, and because standard corporate law should apply so as to more readily limit the liability of members, directors and officers, the non-share capital corporation, rather than the trust, has become the vehicle of choice. Often, the corporation will be incorporated under the federal *Canada Not-for-profit Corporations Act*<sup>4</sup> (CNCA), a modern statute that has been in force since 2011. The application for registered charitable status is filed with the CRA on behalf of the organisation. To receive charitable status, it must be shown in essence that the organisation's proposed purposes and activities are charitable, as defined under Canadian charity law.

- What is charitable is not defined in the ITA or other legislation; rather, in Canada, it is established by common law (essentially set out in a 19th-century decision of the UK House of Lords)<sup>5</sup> as being the work of those organisations established in service of one or more of the so-called four 'heads of charity'. These are: for the relief of poverty; for the advancement of education; for the



advancement of religion; or for other purposes beneficial to the community.

- The application to the CRA is often a streamlined process, submitted on a prescribed form, and, if properly prepared, charitable status is typically granted in three to six months. So long as the proposed activities of the organisation allow for it, it is key, when preparing the application, to properly characterise the organisation's purposes and activities as being for public benefit and falling under one or more of the heads of charity. The CRA can later review and audit the charity's activities to verify that they are charitable and follow stated purposes, and the charity files with the CRA an annual information return that reports, for example, on activities and financial statements.
- The charity is exempt from Canadian federal and provincial income tax. Donations to the charity provide the donor with a Canadian tax credit of roughly 50 per cent (for individual donors) or a Canadian tax deduction (for corporate donors) equal to the corporate donor's tax rate.

### CANADIAN RESIDENCE

The Canadian charity can operate anywhere in the world, but it must have been created or established in Canada (forming a Canadian non-share capital corporation or Canadian charitable trust will satisfy this), and must reside in Canada.<sup>6</sup> Conveniently, if the charity is incorporated in Canada, it will be deemed to reside in Canada.<sup>7</sup> Compare this to a Canadian charitable trust, which requires that management and control of the trust be in Canada in order for the trust to reside in Canada.<sup>8</sup> Therefore, it appears possible for the Canadian charity established as a corporation to have directors, and an asset base, that are not in Canada. Notably, the CNCA, under which federal corporations are incorporated, does not impose a residency requirement on directors. The ITA, however, does require that the books and records of the charity be kept in Canada, and the CNCA requires that the

charity have a registered office in Canada. Additionally, the charity may decide that it wishes to place its endowment in Canada, although this is not a requirement.

As the members of the charity appoint the board, it could be foreseen that these members, while maintaining their status as such, would be the same as the directors, and would include (and could be entirely composed of) the philanthropist-founder and their family. The founder could even be the sole member, and although a minimum of three directors are usually required, the founder could even be the sole director under the federal CNCA, so long as the organisation does not solicit donations from the public. For a CNCA corporation, the directors can be members, but need not be so.

### CHARITABLE ACTIVITIES

As the organisation is controlled at the board level by related persons, and because the principal funder of the organisation, at any one or more times, is likely to be related to the persons controlling the board, the organisation is classified under the ITA as a 'private foundation', and not a 'public charity'. As a private foundation, the charity is not allowed to carry on a business (i.e. although it may have passive investments such as a portfolio of marketable securities, and even real estate if passively invested, it cannot carry on a charitable activity with the intention of earning a profit), but this should not hinder the charity from carrying out material philanthropy.

For example, in the Home Country, the charity as a private foundation could:

- Carry out one or more charitable activities under one or more of the four heads of charity, therefore resisting the conventional wisdom that limits a private foundation to the traditional function of only donating funds to other Canadian charities. However, to do this, it is necessary for the charity to intend not to earn a profit through the activities. For example, in the Home Country, the charity could perhaps provide seminars for all interested nurses and doctors on certain new healthcare procedures. The

seminars would have a detailed plan or syllabus, and learning by attendees of the seminar material would be assessed. The charity would finance the seminars, but earn little or no revenue from them, so would earn no profit. Applicable laws in the Home Country would have to be respected. Such purposes and activities may well satisfy at least two of the four heads of charity: advancement of education and other purposes beneficial to the community.<sup>9</sup> The charity would have to maintain direction and control (through an agent, for example) over how these activities were carried out.

- Donate funds to universities located worldwide, including in the Home Country, if the universities in question are on an extensive list, established under the ITA, of universities that are ordinarily attended by Canadians. This can be a way for the charity, through a university, to place funds in the Home Country for good works, but without the charity having to maintain the same direction and control over use of the funds required in the preceding example.

### CONCLUSION

Philanthropists and their advisors should know that a Canadian private foundation can be an appropriate vehicle for carrying out philanthropy worldwide. As this brief review shows, such an organisation has a number of interesting characteristics: initial and ongoing review of the foundation's purposes and activities by the CRA, thereby promoting recognised good governance; the ability for founders to retain control of the foundation; the benefit of a long-standing body of law and administrative practice setting out the applicable rules; the security of a jurisdiction such as Canada, where deposit and investment of the foundation's endowment is available on a tax-free basis; and disbursement of the endowment for use anywhere in the world.

<sup>1</sup> Although likely applicable to some charities in every country, for one example, see Sarah Hasselbarth, *Islamic Charities in the Syrian Context in Jordan and Lebanon*, Bibliothek der Friedrich-Ebert-Stiftung (2014), [bit.ly/2pPLDkZ](http://bit.ly/2pPLDkZ), which refers to charities in Jordan and Lebanon carrying out valuable work, but which, in that author's view, do not always meet donors' transparency requirements <sup>2</sup> RSC 1985, c 1 (5th Supp) <sup>3</sup> Primarily at s1491 <sup>4</sup> SC 2009, c 23 <sup>5</sup> *The Commissioners for the Special Purposes of Income Tax v Pemsel* [1891] AC 531 <sup>6</sup> ITA, s248(1) <sup>7</sup> ITA, s250(4) <sup>8</sup> *Fundy Settlement v Canada*, 2012 SCC 14 <sup>9</sup> See the Supreme Court of Canada decision of *Vancouver Society of Immigrant and Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10



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