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2019 Cumulative Supplement

Fourth Edition

Michael I. Sanders

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joint ventures involving tax-exempt organizations

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To my wife of 50 wonderful years, Judy,
whose love, devotion, and patience
have made this book possible;
and to David, Patty, Hayley, and Jacob;
Noah, Brooke, Emme, and Ryder Aaron;
Adam, Randi, Gabby, and Eva;
and Sammy, Rebecca, Benjamin, and Jonah.

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Preface

It seems that whenever I sit down to write the preface of an annual supplement or new edition, I'm struck by the increasing challenges exempt organizations face in raising and keeping financial resources to fund their exempt programs. . . . We do not yet know whether the anticipated reduction of charitable giving due to the increased standard deduction will occur long term, but, as reported in "Giving USA 2019: The Annual Report on Philanthropy of the Year 2018," individual giving declined 3.4 percent adjusted for inflation.[1] Of course, all of these factors lead to greater pressure for organizations to be creative in their approach to increasing revenue, including the participation in joint ventures.

The charitable sector has faced additional challenges because of media attention to alleged improprieties occurring at some high-profile organizations, with the so-called Varsity Blues and NRA investigations garnering much coverage. Varsity Blues involves criminal charges against a private college admissions advisor who accepted donations to a charity he had established in exchange for a promise of assistance in the admissions process to parents of college applicants.[2] The charges against the advisor, who has pled guilty, and the parents involve allegedly false representations regarding the abilities and qualifications of the student applicants. For our purposes, however, the more important factor relates to the basic structure of the transactions, whereby the parents claimed charitable deductions for "contributions" the college advisor allegedly used to make payments to coaches, athletic departments, and college testing monitors. There are also allegations of inappropriate spending activities at the NRA, alleged improper political activity by a high-profile private foundation, and alleged practices resulting in impermissible private benefit to numerous leaders at a large state medical system. It is noteworthy that as far as is publicly known, perhaps due to confidentiality of taxpayer information, state Attorneys General or U.S. Attorneys, and not the IRS, have spearheaded the investigations into these matters.

On the other hand, the charitable community welcomes the new opportunity zone legislation that was included in the 2017 Tax Act and incentivizes individual and corporate investments in qualified census tracks that have been designated by state governments. In October 2018 and April 2019, the Treasury Department issued proposed regulations that provide

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[1] https://givingcompass.org/pdf/key-findings-from-giving-usa-2019-the-annual-report-on-philanthropy-for-the-year-2018/?gclid=Cj0KCQjwiILsBRCGARIsAHKQWLPcEVK7oLPoxRPDhYMkkXhtcdLWslC4Ez0aD9iOQJbrJVBtJ7gBJ7EaAkWWEALw_wcB.

[2] https://www.nytimes.com/2019/03/12/us/college-admissions-cheating-scandal.html.

answers to many open questions related to structural issues in organizing opportunity-zone funds as well as second-tier opportunity-zone businesses. This guidance provided answers to many open issues related to the definition of substantially all, the use of qualified OZ business property, the treatment of leased tangible property, the sourcing of gross income in a QOZ, a reasonable period of QOFs to reinvest proceeds from the sale of qualifying assets without paying a penalty, and various other topics. While the guidance can generally be relied upon by taxpayers, there still remain a number of unanswered questions, which are discussed in Chapter 13.

Although the ultimate impact is not yet foreseeable, the 2017 Tax Act is stimulating exploration of planning techniques and structural changes that might reduce the tax impact. For example, if a tax-exempt organization has several unrelated businesses that are now treated as separate and "siloed," should they be "dropped" into one or more C corporations so that the revenue from all can be offset by losses, thereby reducing the tax paid at the 21 percent rate? In many cases, a joint venture would be suitable to attract funds to support charitable projects. In light of the reduced corporate tax rate, would a C corporation be an appropriate joint venture vehicle as compared to the traditional LLC? How do the changes to IRC Section 163(j), limiting deductibility of NOLs to 80 percent with perpetual carryforward, affect planning? What impact does the Code section 4960 excise tax have on volunteer services? Analysis of these issues will depend a great deal on additional IRS guidance and could be affected, and potentially upended, by future Code changes, such as tax rate increases, if Congressional party leadership changes in future elections.

In Chapter 2, there is further discussion of Section 501(c)(4) organizations and the attempt by the IRS to change the long-standing policy with regard to disclosure of donor names, which had traditionally been done on Form 990 for transparency. There is also discussion of the Panera Bread Foundation case, which examines the relationship between a for-profit and nonprofit organization, where the foundation provides grants and assistance by giving away free food. Finally, the chapter examines the extension of the mandatory electronic filing of annual information returns and the impact of the Varsity Blues investigation on the charitable community.

In Chapter 3, there is a discussion of the final regulations relative to partnership audits that were published in February 2019. The focus is on a partnership that is interested in electing out of the audit regime.

In Chapter 5, in the context of private inurement and private benefit, there is a discussion of major news stories involving the National Rifle Association and the University of Maryland Medical System, which brings into consideration the adoption of conflict-of-interest policies (see Appendix 12A) and the focus on good governance.

In Chapter 6, there is discussion of the use of the LLC in comparison with other business entities in structuring a joint venture, including the potential benefits of foregoing tax exemption in the philanthropic community. There is also a further discussion on social impact bonds and impact investment, including a summary of the work of Sean Delany and Jeremy Steckel, the article “Balancing Public and Private Interest in Pay for Success Programs”; the authors conclude that despite the inconsistent jurisprudence surrounding the private benefit doctrine, applying it to pay for success programs demonstrates that it protects against valid concerns not addressed elsewhere in the Code.

In Chapter 8, there is further discussion of the new UBTI “silo” rule. The IRS recently issued interim guidance in Notice 2018-67. There is an analysis, in the context of ownership change, as to whether the net operating losses of a tax-exempt entity can be used by a surviving tax-exempt corporation in a merger. Finally, there is a discussion of the new tax under the 2017 Tax Act on transportation fringe benefits and qualified parking.

In Chapter 10, there is a discussion of the new section 4943(g), the legislation that was intended to provide a lifeline to Newman’s Own Foundation.

In Chapter 13, there is detailed analysis of some significant changes relative to the low-income housing tax credit section, new market tax credits, and the recent regulations covering the new opportunity zone funds, which have received significant national attention. As to nonprofit-sponsored LIHTC projects, some nonprofits have taken somewhat aggressive positions in an attempt to in effect compel renegotiation of their financial upside in transactions that have closed years earlier. There is also discussion of the various interpretations of Section 42(i)(7) that continue to result in uncertainty among nonprofit entities, project investors, and for-profit partners as to the applicability of the “right of first refusal.” There is also a brief update on the 2019 new market tax credit allocation by the CDFI Fund; the NMTC program will terminate after the 2019 round unless it is extended by Congress before year-end. Finally, there is an expanded analysis of the Treasury-proposed regulations relative to opportunity zone funds, the new potentially “dynamic” tax incentive program that was created to spur economic growth in an investment in designated distressed communities. The proposed regulations, which were published in October 2018 and April 2019, provide significant guidance that answered many of the questions that investors and practitioners had about the incentive program. However, there are still a number of unanswered questions, which are discussed in Chapter 13. In addition, as Appendix 13B, I have attached the Tax Compliance Checklist for U.S. taxpayers who invest in opportunity zone funds; this checklist was prepared by Paul Saint-Pierre of PSP Advisors and outlines many of the significant compliance issues.

In Chapter 14, relative to joint ventures with universities, there is discussion of the publication of the nondiscrimination policy in the form of Revenue Procedure 2019-22 (the first IRS publication in 45 years), which relates to school nondiscrimination policy.

In Chapter 16, conservation organizations involved in joint ventures are studied, including an examination of additional rulings and cases that affect the rules.

The bottom line once again: there is no one paradigm for joint ventures, especially in the face of the 2017 Tax Act and its continuing pressures on fundraising. Tax-exempt organizations and their for-profit counterparts need to be creative; that is, be flexible and forge new paths to create and solve many issues affecting the future and the operations of the organization. This text is intended to suggest mechanisms to accomplish the very worthy goals referenced in the charitable community. The opportunity zone fund legislation is likely to create an extremely attractive alternative and allow funds to be redirected into designated census tracts. In addition, many socially minded organizations may attempt to be reclassified as a Section 501(c)(4) structure as compared to a 501(c)(3); see Chapter 2 in this regard. And finally, many prominent philanthropists may forego tax exemption to accomplish to charitable goals (see Section 6.8).

Acknowledgments

I gratefully acknowledge the assistance of my colleagues at Blank Rome, LLP, especially Gayle Forst for her contributions and time in the research and review of the manuscript of the Supplement. I want to call attention to the work of Isak Khorets, graduate student at the Georgetown University Law Center, for his research on Section 4960; Amanda H. Nussbaum, who presented at Georgetown University Law Center on UBIT in PE practices, qualified transportation fringe benefits, and qualified sponsorship payments; Sean Delany and Jeremy Steckel, for allowing me to review their article "Balancing Public and Private Interest in Pay for Success Programs: Should We Care About the Private Benefit Doctrine?"; and Paul Saint-Pierre, the principal advisor of PSP Advisors, LLC, for his draft of the tax compliance checklist for U.S. taxpayers investing in qualified opportunity funds, which is included as an appendix to Chapter 13. I also thank Ronald Schutz at Alliant Group for his review and draft of the current of developments regarding conservation organizations.

I especially acknowledge Linda Schrader, whose extraordinary kindness and sensitivity have been invaluable in the preparation of the manuscript as well as her coordination with the staff of John Wiley & Sons; Linda has been critical to the entire process over the decades.

CHAPTER 1

Introduction: Joint Ventures Involving Exempt Organizations

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§ 1.4 UNIVERSITY JOINT VENTURES

p. 11. ***Add the following new paragraph at the end of this section:***

There is continued congressional focus on university endowments in light of the soaring cost of tuition and the perceived relatively low rate of financial assistance provided by colleges and universities with substantial endowments. See Chapter 14 for a discussion on policy changes that are being proposed, including imposing an annual payout requirement on endowment funds, among others.

§ 1.5 LOW-INCOME HOUSING AND NEW MARKETS TAX CREDIT JOINT VENTURES

pp. 13–14. ***Delete the last paragraph on p. 13 and replace with the following:***

The CDFI Fund has made 1,032 awards totaling $50.5 billion in allocation authority since the NMTC Program's inception. Through January 2017, CDEs disbursed a total of $42.8 billion in QEI proceeds to more than 4,224 qualified active low-income community businesses (QALICBs).

§ 1.6 CONSERVATION JOINT VENTURES

p. 15. ***Add the following to the last paragraph of this section:***

In January 2014, Treasury and the IRS issued Revenue Procedure 2014-12, 2014-3 I.R.B. 414, which established a safe harbor for federal historic tax credit investments made within a single tier through a master lease pass-through structure. The guidance was issued in response to the *Historic Boardwalk* decision referenced earlier.

§ 1.8 REV. RUL. 98-15 AND JOINT VENTURE STRUCTURE

p. 18. ***Add the following to the end of footnote 65:***

PLR 201744019 (revocation of exemption of a § 501(c)(3) exempt hospital that was not operated exclusively for § 501(c)(3) purposes because it lacked ability to require for-profit manager to operate for charitable purposes.)

§ 1.10 ANCILLARY JOINT VENTURES: REV. RUL. 2004-51

p. 21. ***Add the following new paragraph to the end of this section:***

In section 4.10, there is an analysis of a virtual joint venture hypothetical, as to which a similar rationale should apply in a case in which the IRS proposes the revocation of an existing 501(c)(3) organization, alleging impermissible private benefit following an examination of its relationship with a for-profit entity. This commentator believes that the rationale should apply, notwithstanding the fact that no formal joint venture arrangement exists between the parties.

§ 1.14 THE EXEMPT ORGANIZATION AS A LENDER OR GROUND LESSOR

p. 28. ***Insert the following new paragraph at the end of this section:***

The Internal Revenue Service recently issued final guidance for private foundations that updates examples that relate to program-related investments that pass muster under § 4944(c). The rules (T.D. 9762) provide changes and examples that were first provided in the 2012 Proposed Regulations. See subsection 6.5(b) for a detailed discussion of the new examples.

In April 2016 the IRS issued final guidance for private foundations that updates a number of examples of program-related investments that won't trigger excise taxes. Final Rules (T.D. 9762) illustrate changes to the

examples provided in the 2012 Proposed Rules. In one change involving Example 11, a private foundation that invested in a drug company subsidiary developing a vaccine for disease predominantly affecting poor people in developing countries recognizes that, in addition to distributing the vaccine at affordable prices, the subsidiary is allowed to sell the vaccine to those who can afford it at fair market value prices. In Chapter 6, each of the examples and its revised Treasury guidelines are set forth.

§ 1.15 PARTNERSHIP TAXATION

(a) Overview

p. 30. ***Add the following new paragraph to the end of this subsection:***

In the Bipartisan Budget Act of 2015, the partnership audit rules have been revised, the effect of which is that adjustments of income, gain, loss, deduction, or credit are to be determined at the partnership level and the taxes attributable thereto will be assessed and collected at the partnership level. The new rules are effective beginning taxable years after December 31, 2018, although small partnerships may opt out before then. See Chapter 3 for a discussion of the application of the new rules.

(b) Bargain Sale Including "Like Kind" Exchange

p. 30. ***Add the following to the end of footnote 101:***

See discussions regarding contribution of LLC/partnership interests to charity in subsection 2.11(f), *infra*, and Section 3.11, Sale or Other Disposition of Assets or Interests.

§ 1.17 USE OF A SUBSIDIARY AS A PARTICIPANT IN A JOINT VENTURE

p. 34. ***Add the following paragraph after the first full paragraph on this page:***

In September 2015, National Geographic Society formed a joint venture with 21st Century Fox, called the National Geographic Partners, a for-profit media joint venture. In this new venture, Fox contributed a substantial amount of cash to National Geographic, which increased its endowment to nearly $1 billion, in exchange for the contribution of significant assets, including its television channels and related digital and social media platforms. See subsection 6.3(b)(iv) for an analysis of the structure.

§ 1.22 LIMITATION ON PRIVATE FOUNDATION'S ACTIVITIES THAT LIMIT EXCESS BUSINESS HOLDINGS

p. 45. ***Add the following footnote to the end of this section:***

[163.1]See discussion regarding the contribution of LLC/partnership interests to charity in subsection 2.11(f).

§ 1.24 OTHER DEVELOPMENTS

p. 47. ***Add the following as footnote 175 to the last sentence of this section:***

[175]In *Burwell v. Hobby Lobby Stores, Inc.*, the Supreme Court cited p. 555 in this book, which described Google.org advancing its charitable goals while operating as a for-profit corporation. See footnote 24 of the *Hobby Lobby* decision, 134 S.Ct. 2751 (2014). The court recognized that while operating as a for-profit corporation, it is able to invest in for-profit endeavors, do lobbying, and tap Google's innovative technology and workforce. It acknowledged that states have increasingly adopted laws formally recognizing hybrid corporate forms.

CHAPTER 2

Taxation of Charitable Organizations

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§ 2.11 **Charitable Contributions (Revised) 27**

§ 2.1 INTRODUCTION (REVISED)

p. 50. ***Insert quotation marks around* IRC *on line 8 and add a comma after* contributions and churches *in footnote* 2.**
p. 52. ***Insert the following after the last paragraph of this section:***

In the 2017 Tax Act (Pub. L. No. 115-97) (the "Tax Act"), the following changes affect tax-exempt organizations:

1. **New 2017 Legislation**

   (A) Charitable contributions are likely to decline as a result of the lowering of the individual income tax brackets (a maximum rate of 37 percent) while doubling of the standard deduction. These rates and the standard deduction sunset after December 31, 2025. It is projected that only 5 percent of taxpayers will have sufficient itemized deductions that exceed the standard deduction that will enable them to continue to claim a charitable contribution deduction, which may curtail charitable giving. Moreover, the estate tax exemption was doubled so that individuals now have $11 million of exemption and married couples are able to exclude $22.4 million from their estate tax.

This provision also sunsets after December 31, 2025. Finally, there is a reduction in the C Corporation rates to 21 percent, which is a permanent change. It is important to note that C Corps have been the largest investor in joint ventures including the low income house tax credit and new market tax credits. (See Chapter 13.)

(B) The AGI annual limitation has been increased to 60 percent for cash contributions; the provision also sunsets after December 31, 2025. There is obvious concern that major donors are likely to be the only taxpayers in a position to give away up to 60 percent of their AGI in a given year. In addition, the rule that requires contemporary written acknowledgment (§ 170(f)(8)(D)) no longer applies if the donee organization files a return that includes similar content. See subsection 2.11(f). The charitable sector benefits because they have been pressured by donors to fill forms out in lieu of providing a standard acknowledgement. The proposed regulations required the reporting of the donors tax ID numbers/FNS, and charities were concerned that it could lead to theft.

(C) Code § 4960 proposes a new 21 percent excise tax on tax-exempt organizations (modeled on § 162(m)) for (i) any "remuneration" paid to a covered employee that exceeds $1 million (whether or not such amounts are reasonable) and (ii) on "excess parachute payments" paid to a covered person under a separation agreement (i.e., severance payments that exceed 3 times the person's annual compensation averaged over the past five years). In this regard "covered employees" include the top 5 most highly compensated employees (or former employees) from the tax year or anyone who was a covered employee from any preceding taxable year beginning in 2017. "Remuneration" is defined as "all wages" under § 3401(a), excluding Roth contributions, paid by a tax-exempt organization or related party with respect to employment of the covered person. See subsection 5.4(b).[5.1]

CAVEAT
The intermediate sanctions and excess benefit rules of Code § 4958 still apply.

[5.1] For a more detailed discussion of the scope of Code §4960 and the 2019 Interim Guidance, see Section 5.4.

CAVEAT

The Act extends these new executive compensation limitations to tax exempts not limited to 501(c)(3)s or 501(c)(4)s, but including businesses, federal and state and local entities under § 115(1), and political organizations. Unlike the intermediate sanctions excise tax, § 4960 taxes applies to the organization itself not covered employee or organizational manger.

The excess tax applies to deferred compensation remuneration, which is viewed as paid where it is no longer subject to a substantial risk of forfeiture under § 457(f)(3)(B). Thus amounts that are "vested" but not yet received by a covered employee will be subject to tax.[5.2]

(D) There is a new unrelated business income tax (UBIT) on transportation, parking, and gym fringe benefits unless the amounts are deductible under Code § 274 because they are treated as part of the employee's taxable compensation.

(E) The unrelated business income tax rate is now 21 percent, which will provide relief to many exempt organizations, which have been paying as much as 35 percent on unrelated taxable income. However, this rate reduction may be offset by the new rule that net operating losses from one activity may no longer offset income from another activity. Tax-exempt organizations will need to calculate tax on each unrelated business separately.

QUERY

May all "investment" activities be treated as one activity for offsetting purposes? Will each of the gains and losses have to be separately stated? Treasury will need to publish regulations to resolve this issue.

(F) There is now a new 1.4 percent tax on net investment income of certain colleges and universities defined as "applicable educational institutions" (i) that have at least 500 tuition-paying students, (ii) that have more than 50 percent of tuition-paying students located in the United States, and (iii) whose assets aggregated at fair market value are at least $500,000 per student at the end of the preceding taxable year. See Section 14.1. Related organizations to colleges and universities are required to have their assets and net income considered when determining whether the institution meets the asset-per-student threshold and for purposes for determining net investment income.

[5.2] There is special carve-out to payments made to licensed medical professionals such as physicians and veterinarians so that the compensation related to performance to medical services will not count toward the $1 million threshold. Accordingly healthcare organizations will need to track time allocated between medical services and administrative services.