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Arts theater qualifies for real estate exemption

A community theater promoting independent and art films qualifies as an organization that relieves the government of some of its burden and qualifies for real estate tax exemption in Pennsylvania. The state Commonwealth Court has reversed a trial court and granted exemption to the Pocono Community Theater in East Stroudsburg.

The stated purpose of the theater is to "provide independent and art films offering a unique cinematic experience that enlivens the human spirit and promotes learning." It also promotes local artists on the stage and in exhibitions. The theater hosts about 100 events each year, including artist receptions, lectures, and programs for members, organizations and students. The theater is funded by ticket sales, contributions and membership fees.

When it sought exemption in 2013, the county denied the request and a trial court denied an appeal. The trial court reasoned that although the theater provided educational programs, those programs were not "a significant portion" of its efforts and it focused on its movie theater business. While supporting local nonprofit groups "is an honorable undertaking," it is "not relieving the government of its burden in a significant way," the trial court said.

The Commonwealth Court took a different view. Pennsylvania law requires that an "institution of purely public charity" eligible for exemption must meet five tests: (1) advance a charitable purpose; (2) donate or render gratuitously a substantial portion of its services; (3) benefit a substantial and indefinite class of persons who are legitimate subjects of charity; (4) relieve the government of some of its burden; and (5) operate entirely free from private profit motive. Only the fourth prong of the test was contested.

The theater supports and advances causes that the government has chosen to support, the Commonwealth Court wrote. It permits performing arts groups and art exhibits to use its facility for free, which is the kind of activity the Pennsylvania Council on the Arts has been established to foster. The city had also adopted a ten-year plan to expand support of the performing arts to enhance the city's cultural appeal. "Screening films, whether first-run or 'art' films, is a cultural activity, which is why museums of every type also screen films," the Court said. Since the theater "provides benefits to causes that the government supports and advances even though it is not obligated to do so," the Court found that it relieves the government of a burden for purposes of the five-point test.

The trial court also reviewed the theater's qualification under the state law setting forth criteria for qualification (a law that the state Supreme Court had previously ruled is an additional set of criteria and does not set forth the constitutional test for the courts (see Nonprofit Issues, 4/1/12)) and found that it failed on two counts—that it did not show that its assets would continue to be used for charitable purposes in the event of dissolution and that it did not render gratuitously a substantial part of its services. Although the theater did not introduce its articles of incorporation into evidence, the Commonwealth Court concluded that because it had a 501(c)(3) exempt status from the IRS and because the IRS requires that remaining net assets be used for charitable purposes in the event of the dissolution of a 501(c)(3) organization, the governing documents must contain that protection.

The Commonwealth Court also ruled that it met the minimum statutory requirement to subsidize services by at least 5% of the costs. Because the theater had ticket sales and other earned revenue of about $309,000 in the face of expenses of $431,000, with the difference being made up by contributions including membership fees, the Court concluded that it subsidized its activities by more than the 5% requirement. (*Pocono Community Theater v. Monroe County Board of Assessment Appeals*, Commonwealth Ct., PA, No. 679 C.D. 2015, 4/20/16.)

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Congress Stymies Clear Rules For (c)(4) Organizations

New requirement created for notifying IRS of new groups; IRA rollover, other charitable incentives, made permanent

Members of Congress who were outraged that the IRS held up applications by conservative organizations for 501(c)(4) social welfare exemption, which arose in part because the IRS did not know what type and how much political activity is permitted for a (c)(4) organization, have prohibited the IRS from finalizing regulations defining the type and extent of permitted political activity before the 2016 Presidential election.

In its year-end tax and appropriations work, Congress made several other changes with regard to (c)(4) organizations and extended several popular incentives for charitable giving, including making permanent the tax-free IRA roll-over provision for individuals age 70 ½ and older.

The Omnibus Appropriations Bill (in Section 127 of Div. E) prohibits the IRS from acting "during fiscal year 2016" on any guidance "not limited to a particular taxpayer" concerning qualification for 501(c)(4) status and requires the IRS to apply the standard "in effect on January 1, 2010" to "organizations created on, before, or after such date." Unfortunately, the standard on January 1, 2010 was not clear. (See Ready Reference Page: "IRS Proposes New Regulations for 501(c)(4) Social Welfare Organizations") The result of the delay in guidance is that many current donors to (c)(4) organizations will remain secret, unlike donors to political candidates, political parties and political action committees, who must be disclosed to the public.

Congress also prohibited the IRS from imposing a gift tax on contributions to 501(c)(4) social welfare organizations. Members of Congress had challenged the IRS when it sent letters to several donors about their gifts a few years ago. Traditionally, the Tax Code excluded gifts to 501(c)(3) charities and 527 political organizations from gift tax, but had been silent on (c)(4)s, leaving the implication that such gifts should be subject to tax. Obviously, gifts to (c)(4)s for political purposes would be a lot less attractive if the donor also had to pay significant gift taxes on the contributions. The IRS backed off its consideration of imposing the gift tax in the face of Congressional pressure, but the new law (Div. Q, Section 408 of Tit. IV, Subtitle A.)

prohibits imposition of gift taxes on gifts to (c)(4) social welfare organizations, (c)(5) labor unions and agricultural associations, and (c)(6) trade associations, all of which are allowed to endorse or oppose candidates and spend money on elections.

The statute includes a series of other "reforms" stemming from the Tea Party "scandal." It permits the IRS to disclose to complainants whether an investigation is opened or action is taken. It directs the Secretary to set up an administrative appeals procedure for applicants facing an adverse determination of exemption under any subsection of 501(c), and authorizes an applicant to file for a declaratory judgment if exemption under any subsection of 501(c) is denied or delayed. The current declaratory judgment provision applies primarily to (c)(3) organizations and leaves (c)(4)s and other 501(c) applicants in limbo if the IRS doesn't act. The new Act also permits firing IRS staff who act or fail to act "for a political purpose."

The Act also sets up a new procedure (in Section 405) requiring a 501(c)(4) organization to notify the IRS, no later than 60 days after it is established, that it is operating as a (c)(4) organization. No such notification process is now required. The Act establishes a new Section 506 of the Tax Code, pursuant to which the organization must state its name and address, the date and state law under which it was formed, and a statement of its purpose. It is not required to file a Form 1024 to request specific recognition of its (c)(4) status. ((c)(4) organizations are not currently required to file the application but many do so to be sure that they are recognized.) The IRS must acknowledge receipt of the notice. The IRS may confirm the (c)(4) status but is not required to.

The provision applies to newly formed organizations and to (c)(4) organizations in existence that have never filed for (c)(4) status or filed a tax information return. These existing organizations have 180 days after passage of the Act to file their notice.

In the tax extender section, Congress (in Section 112) has removed the annual limitation on the Individual Retirement Account rollover and made the provision applicable without any time limitation. IRA owners over the age of 70 ½ are permitted to make up to a total of $100,000 in gifts directly to charity from their traditional IRAs (not Roth IRAs) without recognizing any income but using the distribution to meet their minimum distribution requirement. Congress made the provision permanent without making any changes in the provisions of the temporary rules. Although the donors are not entitled to a charitable contribution deduction for such gifts, they do not count as income and thereby reduce total adjusted gross income for alternative minimum tax purposes. Many charities have obtained additional current gifts from donors' IRA accounts under the provision that was previously extended from year to year, often by legislation in December of the year in question.

The Act also makes permanent the increased percentage limits and extended carry-forward period for qualified conservation contributions, and makes permanent and expands the enhanced deduction for contributions of food inventory.

YOU NEED TO KNOW

The effort that certain members of Congress are taking to assure the continued flow of "dark money" into the political process is distressing. The hypocrisy of complaining about the IRS's attempts to define the scope of permitted activity of 501(c)(4) organizations and then prohibiting the IRS from doing so is extraordinary.

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California Enjoined From Requiring Schedule B with Registration

Court says requirement to provide names of donors is unconstitutional as applied to 501(c)(3) organization

A federal District Court in California has permanently enjoined the Attorney General of California from requiring a charitable organization to file a copy of its Schedule B disclosure of significant donors with its charitable solicitation registration application for the state. It is the latest and sharpest decision in a series of efforts to reduce the use of Schedule B to provide information to regulators about the donors to charitable organizations. (*Americans for Prosperity Foundation v. Harris*, C.D. CA, No. CV-14-9448, 4/21/16.)

The Ninth Circuit Court of Appeals had held in another case in May, 2015 that the Attorney General's requirement to file the full Schedule B was not unconstitutional on its face. (See *Nonprofit Issues*®, April, 2015) The Attorney General claimed that the information was used for investigatory purposes and not made available to the public.

The Court of Appeals left open the possibility that the charity involved there might be able to show that disclosure would subject their donors to threats or harassment that would warrant relief from the requirement "as applied." Apparently only California and New York have required the unredacted Schedule B submission in order to complete charitable solicitation registration in their states. An attempt to enjoin the imposition in New York has also been rejected by the Second Circuit.

Americans for Prosperity Foundation originally obtained a preliminary injunction from the Central District Court in 2015. Following an appeal by the Attorney General, the case was remanded for consideration in light of the Ninth Circuit's opinion last year.

The Court said that First Amendment challenges of this type of disclosure requirement are reviewed under the "exacting scrutiny" standard. It requires a "substantial relation" between the disclosure requirement and a "sufficiently important governmental interest" and encompasses a balancing test between the governmental interest and the actual burden on First Amendment rights.

Although the Ninth Circuit found that the requirement bore a substantial relation to an important governmental interest, "this Court, unlike the Ninth Circuit," the Court wrote, "had the benefit of holding a bench trial in the matter and was left unconvinced that the At-

torney General actually needs Schedule B forms to effectively conduct its investigations."

The Court said that a supervising investigator for the state had testified that out of approximately 540 investigations over the prior 10 years, only five involved Schedule B and even where it was relied on, the information could have been obtained from other sources. The same investigator testified that he had successfully audited charities and found wrongdoing without the use of Schedule B. "It is clear that the Attorney General's purported Schedule B submission requirement demonstrably played no role in advancing the Attorney General's law enforcement goals for the past ten years," the Court said.

The Foundation also provided testimony that its donors, including Charles and David Koch, had been threatened and at least one had considered stopping funding to the organization.

Although the Attorney General argued that it kept the donors' names confidential and did not release the Schedule Bs to the public, the Foundation identified 1778 forms that had been publicly listed on the AG's website, including 38 which were discovered the day before the trial. "The pervasive, recurring pattern of uncontained Schedule B disclosures — a pattern that has persisted even during this trial — is irreconcilable with the Attorney General's assurances and contentions as to the confidentiality of Schedule Bs collected by the Registry," the Court said. It also said it was "unconvinced" that proper procedures had been put in place to prevent such disclosure in the future.

"The Attorney General's requirement that AFP submit its Schedule B chills the exercise of its donor's First Amendment freedoms to speak anonymously and to engage in expressive association," the Court wrote. It said that the AFP demonstrated that the disclosure requirement had placed donors "in fear of exercising their First Amendment right to support AFP's expressive and associational activity" and that the Attorney General's right to cancel their registration would "preclude it from exercising its First Amendment right to solicit funds in California."

YOU NEED TO KNOW

Efforts are also underway in Congress to eliminate Schedule B entirely, although it has many other uses by the IRS than it might have for a state regulator.

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Fundraising Association Lacks Standing To Challenge Registration Law

Consultant has standing to raise claim that law is unconstitutional "as applied"

A federal District Court in Utah has ruled that an association lacks standing to claim that Utah's statute requiring fundraising counsel to register with the state if their clients solicit charitable contributions in Utah is unconstitutional "as applied." The Court has left standing a prior ruling in the case that a fundraising counsel threatened with penalties if it didn't register has standing to contest the requirement. (*American Charities for Reasonable Fundraising Regulation v. O'Bannon*, D. UT, No. 2:08-cv-875, 9/13/16.)

Utah requires fundraising counsel whose clients solicit in Utah to register even if the counsel has no office in Utah, employs no one in the state, does not work on solicitations directed specifically toward the state, and has no other contact with the state. Utah has enforced its rule by denying registration to charities that employ fundraising counsel that are not registered in the state and by penalizing counsel who don't register directly.

This case was originally filed in 2008 by American Charities for Reasonable Fundraising Regulation and Rainbow Direct Marketing. American Charities is an association including fundraising counsel among its members. Rainbow Direct is a member of American Charities that provides consulting services to advocates for LGBT rights. In 2008, Rainbow Direct was told that it was required to register and would face administrative action if not registered by the time its client sought to renew its registration to solicit as a charitable organization. Rainbow Direct stopped providing services to its client under its contract.

In 2009, the District Court concluded that American Charities had associational standing to litigate the case. (See *Nonprofit Issues*®, 1/1/10.) In 2012, the Court (with a different judge) held that the law was not unconstitutional on its face, but refused to rule on the challenge to the rule "as applied" without more facts. After further discovery, each side filed a motion for summary judgment on the questions of standing. A third judge has now ruled that Rainbow has standing, but that American Charities does not.

Citing the "law of the case" doctrine that legal rulings will not be reversed during the pendency of a case except in extraordinary circumstances, the Court ruled that Rainbow had met the standing test because it had an injury in fact, caused by the challenged conduct,

and a likelihood that the injury would be redressed by a favorable decision. It said that none of the extraordinary circumstances necessary to change the ruling had occurred.

But it said that the requirements for associational standing were not met as the case had developed. Associational standing, it said, requires members who otherwise have standing to sue in their own right, the interests it protects must be germane to the organization's purpose, and "neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit." Although the association met the first two standards, the Court said it could not meet the third in a case challenging the law "as applied."

In arguing that the statute is unconstitutional because the members do not have the minimum contacts with Utah to justify the regulation, the Court said, the argument would be "fact-specific" and could not be brought without the participation of the individual members affected.

The Court recognized that the individual participation element of the test "arises out of prudential considerations" and not the Constitution's case or controversy requirement, but concluded that "administrative convenience and efficiency are best served by requiring each affected … member to participate in the suit so the court can adequately assess the individual contacts of each with the State."

The Court also rejected the association's claim for standing on the basis of an assignment of the claim of one of its members for violation of the member's constitutional rights under Section 1983. While Section 1983 provides no guidance on the validity of an assignment of rights, the Court said, state law in Utah prohibits the assignment of personal injury rights and state law should apply.

YOU NEED TO KNOW

The lack of standing for the association should not prevent the ultimate determination of this question if the consultant directly affected proceeds with the litigation. Utah takes an incredibly broad approach to its jurisdiction over fundraising counsel, and any decision at the District Court level is likely to be appealed. It is the kind of case not likely to be totally resolved without a Supreme Court decision in the matter.