

**THIS YEAR IN NONPROFIT LAW**

**November 30, 2017**

**MIXING POLITICS AND CHARITIES: THE ETHICAL CONUNDRUM  
FOR NONPROFIT LAWYERS AND EXECUTIVES**

**I. Phase I: State Representative Forms “My Nonprofit”**

- A. State Representative (Bertha Bertha) is the founder of a Pennsylvania nonprofit corporation (NP) devoted to neighborhood improvements in her district.
- B. Rep. Bertha is a lawyer. She maintains her PA license but she gave up the active practice of law after her election five years earlier. She realizes NP needs professional advice that she is not competent to give.
- C. Rep. Bertha calls her prior campaign manager (Hannah Hannah), a lawyer who limits her practice to federal, state, and local election and lobbying laws. Rep. Bertha explains that she created “my nonprofit” to improve neighborhoods in her district and asks if Hannah can help her with tax exemption and general operations advice.
- D. Hannah has never formed a nonprofit and knows no federal tax law but she wants to help Rep. Bertha. Having served as Rep. Bertha’s campaign manager, Hannah considers Rep. Bertha a client. Also, Hannah has political aspirations and she wants to help Rep. Bertha so that Rep. Bertha will help her later when Hannah is ready to launch her own political career.
- E. With a how-hard-can-it-be attitude, Hannah asks no questions. Hannah tells Rep. Bertha: “I specialize in nonprofits. I know just what you need. Leave it to me.” Hannah does not send Rep. Bertha or NP an engagement letter.
- F. Hannah promptly attends one PBI Nonprofit Institute and advises Rep. Bertha that NP should apply to the IRS for 501(c)(3) tax-exempt status. Hannah does not consider alternatives to 501(c)(3) status so she offers no advice about them.
- G. Hannah knows that a 501(c)(3) wannabe has to file an application with the IRS. Should it be Form 1023 or Form 1023-EZ?
- H. Hannah reads that the IRS does not closely examine Form 1023-EZ. She figures that, as a political figure, Rep. Bertha might draw IRS scrutiny on issues of campaign intervention or lobbying. After all, Hannah had followed the press reports about the IRS procedures and delays in processing Tea Party-related

applications.

- I. After reading the eligibility requirements to file Form 1023-EZ, Hannah tells Rep. Bertha: “I know your annual gross receipts are likely to be more than \$50,000 in the first three years, but the IRS doesn’t know that so let’s not tell them. Go ahead and file Form 1023-EZ. Your application will be approved in less than a week. You’ll be on your way.”
- J. Rep. Bertha tells Hannah she is too busy to file so Hannah files Form 1023-EZ with the IRS. Hannah signs the Form 1023-EZ even though she is not an officer of NP.

## **II. Phase II: Rep. Bertha’s Nonprofit, now 501(c)(3) Tax-Exempt, Campaign Intervention and Use of NP’s Funds**

- A. Fast forward: NP has been operating as a 501(c)(3) tax-exempt organization for five years. In that time, NP has earned the respect and gratitude of the neighborhoods in Rep. Bertha’s district by arranging for trash and snow removal, resident permit parking, tree plantings, and improved public services. NP is also actively lobbying City Council about zoning matters including electronic billboards.
- B. Rep. Bertha is up for re-election. She asks NP if she can use NP’s building for her campaign kickoff. She also asks NP to provide her with free use of NP’s mailing list and she asks NP’s President to endorse her candidacy.
- C. Hannah advises Rep. Bertha that under applicable election law Rep. Bertha may use NP’s building and mailing list, and NP’s President can endorse her candidacy. Hannah does not research or advise Rep. Bertha regarding 501(c)(3) limitations on campaign intervention.
- D. NP’s President endorses Rep. Bertha. NP allows its building to be used for the campaign kickoff and gives Rep. Bertha a copy of its mailing list.
- E. A week later, Rep. Bertha publicly announces her support for anti-billboard legislation desired by NP.
- F. Rep. Bertha casually tells Hannah that NP has contributed more than \$1,000,000 to her re-election campaign and has spent another \$500,000 on improvements to Rep. Bertha’s home. Occasionally, Rep. Bertha hosts fundraising events for NP at her home.
- G. A State Senator, who is not Hannah’s client, tells Hannah that Rep. Bertha, along with others in State government, regularly uses State computers to share pornographic material.
- H. The IRS initiates an audit of NP after receiving a tip from a local news reporter about the campaign event and Rep. Bertha’s apparent self-dealing.

- I. The IRS proposes revocation of NP's 501(c)(3) status because of campaign intervention and improper private inurement or private benefit. NP's defense: (1) NP relied on advice of counsel in holding the campaign event at NP's building and allowing use of its mailing, both of which happened only once; (2) NP relied on advice of counsel when its President endorsed Rep. Bertha; (3) there was no inurement because Rep. Bertha was not an "insider"; (4) there was no excess private benefit because the money spent on Rep. Bertha's campaign and home served NP's purpose of improving Rep. Bertha's district.
- J. The IRS assesses excess benefit transaction taxes against Rep. Bertha. Rep. Bertha's defense: "I am not a disqualified person."
- K. The IRS contacts Hannah and asks for a detailed explanation of her role in setting up NP, obtaining tax exemption, and giving other legal advice.