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**OPERATIONS AND OVERSIGHT OF
TAX-EXEMPT ORGANIZATIONS**

Testimony of Bruce R. Hopkins

**Tax-Exempt Organizations Law Basics
and Current Developments**

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TAX-EXEMPT ORGANIZATIONS LAW BASICS AND CURRENT DEVELOPMENTS

Chairman Boustany, Ranking Member Lewis, and other Members of the Subcommittee on Oversight, thank you for this opportunity to testify before you on the law of tax-exempt organizations and current developments in this field. I have been a practitioner in this area for over 42 years. I am counsel to a wide range of tax-exempt organizations, including universities, hospitals, other public charities, private foundations, and associations. This practice includes representation of exempt organizations before the Internal Revenue Service.

I have written several books about nonprofit law, including *The Law of Tax-Exempt Organizations*, now in its Tenth Edition. I write a monthly newsletter about nonprofit law developments, titled *Bruce R. Hopkins' Nonprofit Counsel*.

What follows is an overview of the federal tax law applicable to certain tax-exempt organizations.

CHARITABLE ORGANIZATIONS

The federal tax law definition of a charitable organization contains at least 15 different ways for a nonprofit entity to be charitable. These characteristics, found in the income tax regulations, IRS rulings, and federal and state court opinions, include relieving the poor or distressed or the underprivileged; advancing religion, education, or science; lessening the burdens of government; beautifying and maintaining a community; preserving natural beauty; promoting health, social welfare, environmental conservancy, arts, or patriotism; caring for orphans or animals; promoting, advancing, and sponsoring amateur sports; and maintaining public confidence in the legal system. Those most widely claimed are discussed in the discussion that follows.

The relief of poverty is perhaps the most basic and historically founded form of charitable activity. Originally, it meant largely the distribution of money or goods to the poor. In contemporary times, particularly as government has assumed some of this function, it means more the provision of services. This type of charitable entity might feed the homeless or provide them shelter, operate a counseling center, provide vocational training, supply employment assistance, provide low-income housing, or offer transportation services.

The relief of the distressed is a considerably misunderstood way to be charitable. Too many associate distressed with impoverishment. To be sure, one way to be distressed is to be financially distressed (although one can be only temporarily financially distressed). An individual can, however, be physically or emotionally distressed. The confusion as to the scope of the concept of distressed was, most unfortunately, displayed in the aftermath of the terrorist attacks against the U.S. in 2001, when there was a huge outcry and battle as to who was entitled to relief funds—and pursuant to what criteria. While the law tends to precisely define the term poor, the concept of the term distressed is largely undefined and expansive.

The advancement of religion, as a charitable activity, frequently pertains to collateral activities of churches. For example, charitable organizations of this nature may maintain church buildings,

monuments, or cemeteries; distribute religious literature; or supplement salaries. These organizations may conduct programs unique to a particular religion, operate a retreat center, or maintain a religious radio or television station.

The advancement of education, as a charitable activity, includes providing student assistance; advancing knowledge through research; or disseminating knowledge by means of publications, seminars, lectures, and the like. This type of charitable function may be a satellite activity of a particular educational institution, such as a university, library, or museum.

The promotion of health is a separately recognized charitable purpose; in this context, public and mental health are included. This function includes the establishment and maintenance of institutions and organizations such as hospitals, clinics, homes for the aged, and similar treatment or residential centers. Other illustrations of health-providing (or health-promoting) organizations are health maintenance organizations, drug abuse treatment centers, blood banks, hospices, and home health agencies. The advancement of medical and similar knowledge through research, and, generally, the maintenance of conditions conducive to health are included. Classification of an organization as a tax-exempt hospital or a medical research organization is an automatic pathway to avoidance of private foundation status.

The promotion of social welfare is one of the most indefinite categories of charitable endeavors. In the law of trusts, the concept of promotion of social welfare can include such purposes as the promotion of temperance or national security or the erection or maintenance of tombs and monuments. In the federal tax law context, the term embraces activities designed to accomplish charitable purposes, lessen neighborhood tensions, eliminate prejudice and discrimination, defend human and civil rights secured by law, and combat community deterioration and juvenile delinquency.

EDUCATIONAL ORGANIZATIONS

Educational organizations include schools, colleges, universities, libraries, museums, and similar institutions. To be a "formal" educational institution, an organization must have a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at the place where the educational activities are carried on.

There can be a fine line of distinction between an educational activity and a taxable-business. Sometimes it is difficult to distinguish between an educational undertaking and one that amounts to propagandizing—the zealous endorsement of a particular idea or doctrine in a manner that is not reasonably objective or balanced. It is often impossible (and unnecessary) to differentiate between organizations that are charitable because they advance education and those that are educational.

RELIGIOUS ORGANIZATIONS

Religious organizations are the oldest form of tax-exempt organization. Unlike other areas of the law of tax-exempt organizations, religious organizations defy definition. This is due in large part to the First Amendment to the U.S. Constitution, which bars Congress from making any law that would establish religious organizations or prohibit the free exercise of religion.

There are many kinds of religious organizations; the most common form is referred to as a church (including synagogues and mosques). But, here again, the federal tax law lacks a crisp definition of the word church. The IRS has informally defined a church as an organization that satisfies at least some of the following criteria: a distinct legal existence, a recognized creed and form of worship, a definite and distinct ecclesiastical government, a formal code of doctrine and discipline, a distinct religious history, a membership not associated with any other church or denomination, a complete organization of ordained ministers ministering to their congregations and selected after completing prescribed courses of study, a literature of its own, established places of worship, regular congregations, regular religious services, Sunday schools for the religious instruction of the young, and schools for the preparation of its ministers.

Other types of religious organizations, for tax purposes, include conventions of churches, associations of churches, integrated auxiliaries of churches, religious orders, apostolic groups, missionary organizations, bible and tract societies, and church-run organizations, such as schools, hospitals, orphanages, nursing homes, publishing entities, broadcasting entities, and cemeteries.

SOCIAL WELFARE ORGANIZATIONS

Traditionally, a social welfare organization is one that, in the language of the tax regulations, functions to advance the "common good and general welfare," and seeks "civic betterments and social improvements." This type of organization is expected to engage in activities that benefit the community in its entirety, rather than merely its own membership or other select groups of individuals or organizations.

A contemporary use of the social welfare organization is as an advocacy entity. The term social welfare can be broader than the term charitable (even though, as discussed previously, the concept of charitable includes the promotion of social welfare). Social welfare organizations can engage in an unlimited amount of legislative activity without endangering their tax-exempt status, and they can permissibly engage in some political campaign activity. Consequently, some charitable organizations link up with related social welfare organizations as a means of engaging in more lobbying activities than the charitable organizations are allowed to undertake directly.

Like many other tax-exempt organizations, social welfare entities may not engage in transactions that constitute private inurement and may not operate unrelated businesses as a primary activity. The only type of social welfare organization to which contributions are deductible is a veterans' organization.

BUSINESS LEAGUES

A business league is a group of persons (an association) who have some common business interest; the purpose of the league is to promote that common interest. Its activities (if it is to be tax-exempt) are directed to the improvement of business conditions of one or more lines of business, as distinguished from the performance of particular services for individual persons.

CURRENT DEVELOPMENTS

An inventory of current developments in the law of tax-exempt organizations includes the following.

- IRS involvement in nonprofit governance.
- Implications of the revision of the Form 990.
- IRS compliance checks.
- Charitable organizations' involvement in political activity.
- Import of IRS college and university compliance check.
- IRS look at "self-declarer" exempt organizations.
- IRS processing of applications for recognition of exemption.
- Pending regulation projects (including those pertaining to supporting organizations and donor-advised funds).
- IRS charitable spending initiative.
- Supreme Court decision in health care context.
- Status of tax extenders legislation.
- Implications of pending tax reform.