

# STATEMENT FOR THE RECORD

COMMITTEE ON WAYS AND MEANS  
U.S. HOUSE OF REPRESENTATIVES

May 16, 2012

*Hearing on Operations and Oversight of Tax-Exempt Organizations*

1100 Longworth House Office Building  
Chairman Charles W. Boustany Jr., MD (R-LA)

**Mary Beth Hutchins**  
**Communications Director, Cause of Action**

Thank you, Chairman Boustany, for the opportunity to submit this statement for the record to the Committee on Oversight and Government Reform at the U.S. House of Representatives. My name is Mary Beth Hutchins and I am the Communications Director at Cause of Action.<sup>1</sup> Cause of Action is a nonprofit, nonpartisan organization that uses public advocacy and legal reform strategies to ensure greater government accountability and protect taxpayer interests and economic freedom.

One of ways Cause of Action ensures accountability in the federal government is requesting investigations when we see a potential of waste or fraud of taxpayer dollars. Given the recent indication by the Internal Revenue Service (IRS) that it is investigating the abuse of charitable organizations and deductions, we requested that the IRS investigate the Alliance of Californians for Community Empowerment (ACCE), and want to offer you the information we have uncovered about this organization as you consider the oversight of tax-exempt organizations.<sup>2</sup>

## **GENERAL PRINCIPLES OF FISCAL SPONSORSHIP**

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<sup>1</sup> WEBSITE, CAUSE OF ACTION, *available at* [www.causeofaction.org](http://www.causeofaction.org).

<sup>2</sup> Paul Streckfus, *Email Update 2012-31*, EO TAX J., (Feb. 17, 2012), *citing* IR-2012-23 (“IRS examiners continue to uncover the intentional abuse of 501(c)(3) organizations, including arrangements that improperly shield income or assets from taxation and attempts by donors to maintain control over donated assets or the income from donated property. The IRS is investigating schemes that involve the donation of non-cash assets -- including situations in which several organizations claim the full value of the same non-cash contribution. Often these donations are highly overvalued or the organization receiving the donation promises that the donor can repurchase the items later at a price set by the donor. The Pension Protection Act of 2006 imposed increased penalties for inaccurate appraisals and set new standards for qualified appraisals.”)

As the IRS has stated, a “fiscal sponsorship” occurs “when one or more charities choose to financially support another charity or nonexempt project.”<sup>3</sup> According to Gregory Colvin, a leading exempt organizations attorney who is counsel to the Alliance of Californians for Community Empowerment (“ACCE”), the rebranded California ACORN chapter,<sup>4</sup> these arrangements “typically arise when a person or group (we will call this a project) wants to get support from a private foundation, a government agency, or tax-deductible donations from individual or corporate donors,” and “[b]y law or preference, the funding source will only make payments to organizations with 501(c)(3) tax status.”<sup>5</sup> Fiscal sponsorships have also been known as “fiscal agents,” but practitioners disagree on the proper nomenclature.<sup>6</sup>

A fiscal sponsorship relationship can be effectively and lawfully utilized in a variety of situations where a person or group intending to engage in charitable activities wishes to attract tax-deductible contributions without having official exemption by the IRS under § 501(c)(3) of the Internal Revenue Code.<sup>7</sup> For example, “[f]iscal sponsorship is often temporary, used for that period before a new organization obtains its own tax exemption. Other variations occur when a small 501(c)(3) group needs a larger 501(c)(3) organization to manage its financial affairs or seeks IRS classification as a public charity based on its relationship with the sponsor.”<sup>8</sup>

While the IRS has yet to produce concrete guidance on the issue, it has indicated approval of fiscal sponsorships by 501(c)(3) organizations only if certain conditions are satisfied. Specifically, a 501(c)(3) organization is allowed to accept tax-deductible funds on behalf of a non-501(c)(3) entity if the following three conditions are satisfied:<sup>9</sup>

1. The project being carried out by the non-501(c)(3) organization is “in furtherance of [the 501(c)(3)’s] own exempt purposes”;
2. The 501(c)(3) organization “retains control and discretion as to the use of the funds”;
3. The 501(c)(3) organization “maintains records establishing that the funds were used for section 501(c)(3) purposes.”

The IRS has provided examples of appropriate uses of fiscal sponsorships:

1. C, an individual, desires to start a tutoring program in the inner city but does not have sufficient resources or the sophistication needed to apply for tax exemption. C submits a grant application to X Community Foundation for financial support for the tutoring program. X approves the grant,

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<sup>3</sup> 94 TNT 71-46.

<sup>4</sup> Matthew Vadum, *ACORN’s California Makeover*, AMERICAN SPECTATOR, (Jan. 21, 2010), available at <http://spectator.org/archives/2010/01/21/acorns-california-makeover>.

<sup>5</sup> GREGORY L. COLVIN, FISCAL SPONSORSHIP: 6 WAYS TO DO IT RIGHT, 3 (1993) [hereinafter “COLVIN”].

<sup>6</sup> *Id.* For clarity, we will refer to such arrangements as fiscal sponsorships.

<sup>7</sup> TAX ECON. CHAR. GIVING § 3.02

<sup>8</sup> COLVIN, *supra* note 5 at 4.

<sup>9</sup> Rev. Rul. 68-489, 1968-2 C.B. 210.

establishes a fund called the C Fund, and solicits contributions for this fund. X is C's fiscal sponsor.

2. X community foundation approaches S Private Foundation soliciting for C's fund. S makes a grant to X designated for the C Fund. S, in the instrument of transfer, gives X full control over the investment decisions concerning the grant and full discretion in determining how much and when distributions from the fund will be made.
3. X Community Foundation receives a grant request from Z Charity. X reviews and approves the request. X establishes the Z Fund, and solicits contributions for this fund.

In each of the above situations, X acts as a fiscal sponsor; notice that in the second situation, S, a private foundation, is relieved of exercising expenditure responsibility because it gave X full control over the grant's income and corpus.<sup>10</sup>

### **MISUSE OF FISCAL SPONSORSHIP**

Several legal experts have opined that fiscal sponsorship can be misused by organizations wishing to skirt various Federal laws. For instance, such arrangements can be used as a “passthrough, or conduit, or laundering arrangement where the (c)(3) is really doing no more than receiving money from a donor or foundation and passing it on to a person or an organization that does not have (c)(3) status.”<sup>11</sup> John Edie, a leading nonprofit tax attorney, described a fiscal agent as a “laundering agent,” and added, “[i]f you're going to use a fiscal agent, to me you're saying, ‘Well, I'm going to launder the money through somebody.’”<sup>12</sup>

According to Lee Sheppard, an editor at *Tax Analysts*, “[a] fiscal agent is a money laundry. People who want to finance projects that would not, if separately incorporated, have a charitable purpose often form an exempt organization . . . to act as a conduit[ ] for the money used to finance the project so that its backers can claim a charitable deduction.”<sup>13</sup> Sheppard noted that “fiscal sponsorship . . . is a common practice, and one that the IRS should shut down.”<sup>14</sup>

Even Gregory Colvin, a leading proponent of fiscal sponsorship relationships, has voiced concerns over their misuse: “[i]f the control mechanisms are not administered properly, [a fiscal sponsorship arrangement] can collapse into a ‘conduit’ or ‘step transaction’ in which the IRS will disregard the role of the sponsor and declare that the funding source has, in effect, made a payment directly to a non-501(c)(3) project.”<sup>15</sup>

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<sup>10</sup> 94 TNT 71-46.

<sup>11</sup> COUNCIL ON FOUNDATIONS, TOP TEN WAYS FOUNDATIONS GET INTO TROUBLE (2008), available at [http://www.washingtongrantmakers.org/s\\_wash/images/client/TopTenTrouble.pdf](http://www.washingtongrantmakers.org/s_wash/images/client/TopTenTrouble.pdf).

<sup>12</sup> *Transcript of the Winter ABA EO Committee Meeting: Panel Six: The Use and Misuse of Fiscal Sponsorship Arrangements*, 7 EXEMPT ORG. TAX REV. 570, 571(1992).

<sup>13</sup> Lee Sheppard, *Charitable Money Laundering*, 8 EXEMPT ORG. TAX REV. 645 (1993).

<sup>14</sup> *Id.*

<sup>15</sup> COLVIN, *supra* note 5, at 28.

Distressingly, fiscal sponsorships can and have been used as conduits for political activity. I.R.C. § 501(c)(3) prohibits (c)(3) organizations from engaging in political activity.<sup>16</sup> However, the IRS itself has recognized the potential for misuse of fiscal sponsorships, particularly by using a 501(c)(3) organization as a conduit for an improper transaction, and has provided potential examples:

1. X, a philanthropist, wants to give to Z, an individual who is poor. X knows that a transfer directly to Z lacks the necessary public benefit to be considered charitable. X would not be entitled to a charitable tax deduction. To avoid this result, X donates money to Y Community Foundation with instructions to distribute it to Z. Y has no discretion as to the distribution of the funds. Here, Y is nothing more than a conduit. X is not entitled to a deduction.
2. C, a private foundation, wishes to support a nonexempt charitable project. (A nonexempt project, as used in this context, is a charitable activity of an organization that does not have an IRS determination letter.) C does not want the burden of exercising expenditure responsibility, but wishes to maintain continuing supervision of the project. C gives the money to Y Community Foundation after Y has agreed that C will maintain continuing control and that the money will be used solely for the project.
3. S, a fledgling organization, is struggling to maintain public charity status. T, a wealthy donor, wants to give S a large contribution. If T gives it directly to S, the contribution will be subject to the two percent of total support limitation and S would fail the public support test. To avoid this, T "earmarks" the money for S and runs it through the Y Community Foundation. Y has no discretion but to distribute the money to S.

In the preceding three examples, Y Community Foundation has no control over the donations. Y is acting as a mere conduit in a transfer between the donor and the ultimate recipient. The donor and the recipient are the only beneficiaries in these transactions.<sup>17</sup>

According to Professor Frances Hill, 501(c)(3) organizations can be attractive for political donors because of the tax deduction they provide. She wrote, "the most likely [corporate-candidate] conduit, and the one offering the greatest benefits, is a 501(c)(3) organization that is absolutely prohibited from supporting or opposing candidates for public office."<sup>18</sup> As Professor Hill noted, 501(c)(3) organizations are attractive due to lax reporting standards: "Because 501(c)(3) contains the absolute prohibition, 501(c)(3) organizations are not subject to the tax reporting requirements imposed on other 501(c) organizations by 527 and they

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<sup>16</sup> See I.R.C. § 501(c)(3) (1986) (providing that an organization qualifies for exemption only if it "does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office.")

<sup>17</sup> 94 TNT 71-46.

<sup>18</sup> Frances R. Hill, *Corporate Philanthropy and Campaign Finance: Exempt Organizations As Corporate-Candidate Conduits*, 41 N.Y.L. SCH. L. REV. 881, 927 (1997).

are not required to register with and report to the FEC.”<sup>19</sup> In other words, a donor wishing to engage in political activities could funnel his money through a 501(c)(3) fiscal sponsor to a third organization and still potentially receive a tax deduction for his contribution.

### **ORGANIZATIONS IN CAUSE OF ACTION’S INVESTIGATION INTO FISCAL SPONSORSHIP**

The Alliance of Californians for Community Empowerment (ACCE) is either a non-exempt organization or a 501(c)(4) exempt organization and Community Partners is a 501(c)(3) charitable foundation that acts as ACCE’s fiscal sponsor. As we show herein, Community Partners may have laundered money on behalf of ACCE. Of the \$712,938 in grants given by Community Partners to other organizations in fiscal year 2010, \$447,495, or approximately sixty-three percent of grant expenditures, was awarded to ACCE, purportedly for “California Alliance Summer 2010 Voter Engagement Programs” and an “Education and Training Program.”<sup>20</sup>

ACCE is a self-professed community organizing “non-profit” organization that fights for “social, economic, and racial justice.”<sup>21</sup> While fiscal sponsorships are legal, it is not legal for a 501(c)(3) organization, such as Community Partners, to give any money to an organization that engages in political activity. Moreover, it is not legal for a 501(c)(3) organization to give such a substantial portion of their grants in fiscal year 2010 to an organization that lobbies. With 63% of its grants for the fiscal year 2010 being sent to a single organization that may engage in activities outside the bounds of the Internal Revenue Code’s (IRC) tax exemption rules, Community Partners should lose its 501(c)(3) tax-exempt status. Additionally, if ACCE is a 501(c)(4) organization – which Community Partners did not indicate on their 2010 Form 990 and Cause of Action has been unable to verify – it must lose its 501(c)(4) tax-exempt status as well due to the overt political nature of the organization.

Additionally, the Applied Research Center (ARC), an affiliate of the Association of Community Organizations for Reform Now (ACORN),<sup>22</sup> served as a fiscal sponsor of the Alliance of Californians for Community Empowerment.<sup>23</sup> While ACCE has previously posted its tax information on *Guidestar.org*, identifying itself as a 501(c)(4) social welfare organization,<sup>24</sup> ACCE no longer has its tax-exempt information publicly available. Instead, a 501(c)(3), the ACCE Institute, located at the same address as ACCE, is identified on *Guidestar*, although no Form 990 is available.<sup>25</sup>

We are concerned ARC might be improperly fiscally sponsoring ACCE, which does not appear to be engaging in (c)(3)-exempt activities. To illustrate this concern, ACCE has recently

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<sup>19</sup> *Id.* at 927-928.

<sup>20</sup> *Infra* note 22.

<sup>21</sup> Mission Statement, “About,” Calorganize.org, last accessed Feb. 24, 2012, *available at* <http://www.calorganize.org/about>.

<sup>22</sup> See ACORN Affiliate List, *available at* <http://www.conservative.org/wp-content/uploads/2010/07/ACORN-Organizations.pdf>.

<sup>23</sup> See FORM 990, APPLIED RESEARCH CENTER, at 2, *available at* <http://www.guidestar.org/FinDocuments/2010/942/759/2010-942759879-0783f452-9.pdf>.

<sup>24</sup> See e.g. Business Entity Search, California Secretary of State Website, *available at* <http://kepler.sos.ca.gov> (search “Alliance of Californians for Community Empowerment”) (Entity Number: C3238528).

<sup>25</sup> See GUIDESTAR WEBSITE, *available at* [www.guidestar.org](http://www.guidestar.org) (“ACCE Institute” in search).

posted a job opportunity announcement online looking for a “Political Field Director” to “support candidates and issues that reflect our memberships values[.]”<sup>26</sup> Moreover, ACCE is a member of Catalist, a data-based organization which helped elect President Obama in 2008.<sup>27</sup> According to the 2009 Catalist report on member activities, “Obama did better where more progressive registration and persuasion work occurred[.]”<sup>28</sup>

Under the Internal Revenue Code a 501(c)(3) may not direct a “substantial part” of its funds to lobbying and political activities. However, sixty-three percent of the money Community Partners granted to all organizations went to ACCE, nearly two-thirds of its grants, which certainly appears to meet the burden under the IRC. It is clear, then, that Community Partners is primarily used as a conduit to shuffle tax-deductible donations to an organization that may engage in both lobbying and political activities, in violation of the law for tax-exempt organizations.

If Community Partners is found to have granted nearly two-thirds of their granted funds for fiscal year 2010 to ACCE and ACCE is found to be either a political organization or engaged in lobbying, then Community Partners should lose its 501(c)(3) tax-exempt status, and ACCE should lose its 501(c)(4) tax-exempt status, if it is still registered with the IRS as such an organization.

Cause of Action respectfully requests that the Committee consider the misuse of fiscal sponsorship by ACCE and Community Partners as you consider the IRS oversight of tax-exempt activities. Thank you for your consideration of our views and investigation. We would be pleased to provide the Committee with any further information the Committee requests.

Sincerely,



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MARY BETH HUTCHINS  
COMMUNICATIONS DIRECTOR

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<sup>26</sup> Job Description, Political Field Director/Coordinator, Alliance of Californians for Community Empowerment (ACCE) (Posted Feb. 13, 2012), *available at* <http://www.idealists.org/view/job/FH4sbCn2BPFP/>.

<sup>27</sup> See “Our Client List,” CATALIST WEBSITE, *available at* <http://catalist.us/clients>.

<sup>28</sup> See REPORT, AGGREGATE ACTIVITIES OF PROGRESSIVE ORGANIZATIONS IN 2008: COMPILATION OF DATA FROM CATALIST SUBSCRIBERS (Summer 2009) *available at* <http://causeofaction.org/wp-content/uploads/2012/05/Catalist-after-action-report.pdf>.