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Donor Reliance on Form 1023-EZ Representations

Article by Jordana G. Schreiber

On July 1, 2014, the Internal Revenue Service introduced a new, streamlined application form to help smaller charities obtain tax-exempt status without having to go through the burdensome process of completing a Form 1023 application. The IRS presented the Form 1023-EZ, Streamlined Application for Recognition Under Section 501(c)(3) of the Internal Revenue Code, as the solution to lengthy processing delays of the traditional Form 1023 application, which often produced a delay of over nine months from the time of filing the application with the IRS until the organization was able to obtain tax-exempt status. Now, organizations whose gross receipts are expected to be $50,000 or less annually can fill out the new Form 1023-EZ to obtain tax-exempt status in an expedited manner.

The Form 1023-EZ asks organizations to "check the box" to indicate that the organization is organized and operating to further one or more of the purposes set forth in section 501(c)(3), that it is not performing any activities that would disqualify it from tax exemption under 501(c)(3) and that its organizing document contains the necessary language to qualify it under 501(c)(3) but requires no other specific information from the organization. When it comes down to it, it is simply a self-certification system. Rather than the Form 1023, in which the organization must provide organizing documents and detail all of its activities and intended activities, the Form 1023-EZ does not even require the organization to supply its organizing document with its application or specifically describe the activities it performs. Furthermore, the IRS makes no real determination upfront that the organization's activities will qualify as tax exempt. The organization may lose its tax-exempt status if, upon a later audit, the IRS determines that it never did qualify.

Generally, when making donations to charitable organizations, donors and contributors may rely on an organization's favorable determination letter under section 501(c)(3) until the IRS publishes notice of a change in status, unless the donor or contributor *was responsible for or aware of the act or failure to act that results in the revocation of the organization's Determination Letter*. See Rev. Proc. 2011-33, 2011-25 I.R.B. 887.

However, Ruth Madrigal, a Treasury Department official in the Office of Tax Policy, said on March 19 that the office is looking at revising some Internal Revenue Service guidance for donors who deduct contributions to public charities based on Form 1023-EZ exemptions (54 DTR G-7, 3/20/2015). The question then arises as to the level, if any, of due diligence a donor must conduct prior to making a donation to a charitable organization that received its tax-exempt status via a Form 1023-EZ. Must a private foundation or other donor determine whether an "incorrect attestation" was made by the charitable organization on

its Form 1023-EZ prior to making a donation?

According to Madrigal, it seems as though the IRS' concerns are mostly with an "insider donor" - a founder, an officer, a director or another person closely affiliated with the charitable organization who knew or should have known there was an issue with the exemption status of the organization. The IRS is concerned that someone would establish an organization, check the box that it qualifies for tax-exempt status (even though it did not so qualify), make contributions to the organization and take charitable deductions for those contributions. The IRS may hold these "insiders" to a higher level of scrutiny than outside donors and disqualify those charitable deductions if it is later found that the organization made an incorrect attestation on its Form 1023-EZ. However, outside donors who truly had no way of knowing whether a charitable organization made a misrepresentation on the Form 1023-EZ should not need to worry about making such charitable donations.

New Jersey Tax Court Invalidates Hospital's Tax Exemption

Article by Christopher John Stracco, Michael James Guerriero and Sylvia-Rebecca Gutiérrez

In a case of first impression, in a decision issued on Friday, June 26, the Tax Court of New Jersey invalidated the real property tax exemption of Morristown Memorial Center, a facility which is part of the Atlantic Health System. The town of Morristown had rejected the hospital's claims for property tax exemptions for the 2006, 2007 and 2008 tax years. The hospital had sought a continuation of its exemption as a nonprofit hospital for those tax years.

Under New Jersey law, generally only nonprofit entities are entitled to tax exemptions. While the Tax Court concluded that virtually the entire property was being used for an exempt purpose, i.e., a hospital use, the key issue was whether the healthcare activities at the hospital were being conducted for profit.

Following a trial, the court concluded that the hospital maintained relationships with a number of affiliated and unaffiliated for-profit entities, as well as owning all the stock in several for-profit professional corporations for physician practices. The employees of these entities were employed by the hospital, and the hospital provided loans termed "working capital" to these practices. There were also other for-profit affiliates, including an insurance company which maintained a line of credit guaranteed by the hospital.

Based on these and other facts, the court found that "By entangling its activities and operations with those of for-profit entities, the Hospital allowed its property to be used for a profit. This commingling of effort and activities with for-profit entities was significant, and a substantial benefit was conferred upon for-profit entities as a result."

The court also found that the hospital failed to meet its burden to establish the reasonableness of compensation paid to its executives, in contravention of New Jersey Supreme Court precedent, which requires that to maintain a tax exemption

nonprofit salaries should be reasonable and not excessive. Moreover, the Tax Court found that physicians' contracts entered into by the hospital demonstrated a profit-making purpose. Hence, the court concluded that, with few exceptions, the town's denial of the hospital's property tax exemption was affirmed.

The value of the hospital for property tax purposes was also challenged, and now that the exemption denial was affirmed, the town will have to defend the hospital's real property tax assessment, which approximates $63 million. The name of the case is *AHS Hospital Corp. d/b/a Morristown Memorial Hospital v. Town of Morristown*, Docket Nos. 010900-2007, 010901-2007 and 000406-2008. The decision has been approved for publication.

'Til Death Do Us Part?: Second Circuit Affirms Validity of Posthumous QDROs

Article by Liza J. Hecht and Daphney Francois

The United States Court of Appeals for the Second Circuit recently held that two posthumously entered domestic relations orders were valid qualified domestic relations orders (QDROs) under ERISA and properly assigned plan funds to the ex-wife of a deceased participant despite the claims of the participant's surviving spouse to benefits under the plans. A valid QDRO is one of the few exceptions to the ERISA prohibition on the assignment or alienation of plan benefits.

Barbara Nicholls, the surviving spouse of Harold Nicholls, and Claire Nicholls, his ex-wife, made competing claims to Harold's benefits under several pension plans sponsored by Yale-New Haven Hospital. Harold and Claire divorced in 2008, and the settlement agreement provided Claire with half of Harold's pension benefits accumulated during their marriage. Furthermore, the settlement agreement preserved the court's jurisdiction to establish or maintain a QDRO acceptable to the plans' administrator. No QDRO was entered into and no pension funds were transferred to Claire during Harold's lifetime.

In 2009, Harold married Barbara. Harold died in 2012, and Barbara was the named beneficiary for each of the pension plans. Later that year, the court entered two QDROs directing the plan administrator to distribute to Claire her assigned portion of the pension benefits consistent with the settlement agreement.

Yale-New Haven Hospital filed an interpleader action in federal court to resolve these competing claims. The district court ruled in favor of Claire, holding that the settlement agreement was a QDRO because it substantially complied with ERISA's requirements. On appeal, the Second Circuit rejected the district court's reasoning, noting the substantial compliance standard does not apply to orders issued after January 1, 1985. Nonetheless, the Second Circuit confirmed the result, relying on the Pension Protection Act of 2006 and subsequent regulations stating that an order meeting ERISA's requirements should not be invalid solely because of the time at which it is issued, including after the death of the participant.

While this case might suggest plan administrators are entering an uncertain world where a posthumously entered QDRO can

lay claim to death benefits already paid, existing case law suggests such fear is unwarranted. Distributions made pursuant to plan terms and *prior* to notice of a conflicting claim should well position a plan administrator to defend against subsequent claims. However, if plan administrators are aware of the conflicting claims *prior* to distribution, they should follow the example set by Yale-New Haven Hospital and ask a court to make the determination. As a matter of best practice, plan administrators should pay benefits in accordance with plan terms and should not get involved in resolving competing claims.

Saying 'Thank You' - The Importance of Acknowledgment Letters for Charitable Contributions

Article by Caroline Robbins

A surge in access to information coupled with the ability for organizations to communicate and spread their message to the public in more ways than ever before has resulted in an increased number of organizations vying for potential donors. Organizations devote enormous resources to attracting donors. It is important to build new relationships, but growing and maintaining already existing relationships, big and small, should not be overlooked. The easiest way to start? Remember to say "thank you."

Saying "thank you" is one of the first lessons parents teach their kids. To most of us, sending a thank-you note is almost second nature when you receive a gift from a family member or friend. Charities should do the same. Beyond common courtesy, acknowledging donors by sending a thank-you note will make them feel appreciated. Without such acknowledgment donors may feel that their contribution did not make a difference, which could lead them to look elsewhere next time they go to write a check.

Not only is saying "thank you" an important part of preserving donor relationships and encouraging continued giving, but it is also necessary from a practical standpoint. In order for an individual to claim an income tax charitable deduction for a donation of $250 or more, the individual must receive contemporaneous acknowledgment of his or her donation from the charity. The IRS states in Publication 1771 that acknowledgment is contemporaneous if it is received prior to the earlier of (i) the date on which the donor files his or her individual federal income tax return, and (ii) the due date (including extensions) of the return.

It may be tempting to forgo an acknowledgment letter when donations are less than $250, but as stated above it is good practice to always send one to say "thank you"; additionally, it is much less of an administrative burden when no one is responsible for making a case-by-case determination of whether a letter should be sent or not.

Charitable contributions are a vital part of all organizations, so do not take contributions of any size for granted, and remember to always take the time to say "thank you."

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