PART II

CURRENT DEVELOPMENTS

by
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1. Announcements

A. Announcement 2000-72, 2000-35 I.R.B. 226, Reporting Requirements for Section 527 Organizations

The Service announced it is considering issuing a revenue ruling to address questions on the reporting requirements for political organizations described in I.R.C. 527. The announcement sets forth 43 proposed questions and answers and solicits public comments on those and other questions. See Rev. Rul. 2000-49, 2000-44 I.R.B. 430, for the published ruling.

B. Announcement 2000-84, 2000-42 I.R.B. 385, IRS Seeks Comments on EO Internet Activities

The Service announced that it is considering issuing guidance that would clarify exempt organizations law with respect to Internet activities. The announcement sought public comment on a number of wide-ranging issues.

C. Announcement 2001-14, 2001-7 I.R.B. 1, Request for Ideas for Exempt Organizations Plain-Language Publications and Voluntary Compliance Programs

This announcement requests comments and suggestions from the public for topics for plain-language publications, IRS internet web-site content, and voluntary compliance programs.

2. Notices, Revenue Procedures and Revenue Rulings

A. Notice 2000-62, 2000-51 I.R.B. 587, Returns Relating to Payments of Qualified Tuition and Related Expenses, and to Payments of Interest on Education Loans

This notifies eligible educational institutions and certain persons who receive payments of student loan interest that they may continue to report the same information under I.R.C. 6050S for year 2001 as required for the years 1998, 1999, and 2000.

B. Rev. Proc. 2001-4, 2001-1 I.R.B. 121, TE/GE Ruling Procedures Revised

This updates guidance on ruling letters and information letters on issues under the jurisdiction of TE/GE. Revisions reflect the reorganization of the Service and the creation of the new TE/GE Division.

C. Rev. Proc. 2001-5, 2001-1 I.R.B. 164, TE/GE Technical Advice Procedures Revised

This updates how technical advice is provided to TE/GE offices and to Appeals offices. It incorporates changes made by the IRS Restructuring and Reform Act of 1998, Pub. L.105-206.

D. Rev. Proc. 2001-8, 2001-1 I.R.B. 239, Rules Updated on TE/GE User Fees

This updates guidance on the user fee program relevant to TE/GE. No major changes are made for 2001 to the EO fee schedule.

E. Rev. Proc. 2001-13, 2001-3 I.R.B. 337, Cost of Living Adjustments for 2001

The revenue procedure sets forth inflation adjustments for tax years beginning in 2001. The items most relevant to TE/GE (EO) are:

1. the I.R.C. 512(d)(1) limitation on the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization is $116.

2. the unrelated business income of certain exempt organizations under I.R.C. 513(h)(2) does not include a “low cost article” of $7.60 or less.

3. the $5, $25, and $50 guidelines for disregarding the value of insubstantial benefits received by a donor in return for a fully deductible charitable contribution under I.R.C. 170, are $6.60, $38 and $76, respectively. See section 3 of Rev. Proc. 90-12, 1990-1 C.B. 471 for further explanation.

4. the annual per person dues limitation to qualify for the reporting exception under I.R.C. 6033(e)(3) for certain exempt organizations with nondeductible lobbying expenditures is $81. See section 5.05 of Rev. Proc. 98-19, 1998-1 C.B. 547.

F. Rev. Rul. 2000-49, 2000-44 I.R.B. 430, Reporting Requirements for Section 527 Organizations

The revenue ruling provides guidance on the notice and reporting requirements for I.R.C. 527 organizations. Fifty-two questions and answers explain how the Service implements provisions of Pub. L. 106-230, which imposes requirements concerning:

1. initial notice of status;

2. periodic reports of contributions and expenditures; and

3. annual returns.

See the 2002 CPE "Election Year Issues" topic for further discussion.

3. Proposed, Temporary and Final Regulations

A. T.D. 8915, 2001-4 I.R.B. 359, 65 Fed. Reg. 82926 (December 29, 2000) Temporary Regulations under I.R.C. 444

These temporary regulations affect S corporations that are affiliated with I.R.C. 501(c)(3) trusts and that wish to elect an alternative taxable year. Under section 444, S corporations may elect to have a taxable year other than the one they are otherwise required to have. Section 1.444-2T generally prohibits an S corporation that is a member of a tiered structure from making this election. An S corporation is considered to be a member of a tiered structured if it owns any portion of a "deferral entity", or a deferral entity owns any portion of an S corporation. T.D. 8915 provides, in part, that an I.R.C. 501(c)(3) trust is not a deferral entity.

B. T.D. 8920, 2001-08 I.R.B 654, 66 Fed. Reg. 2144 (January 10, 2001) Intermediate Sanctions Temporary Regulations.

This document contains temporary and proposed regulations on excess benefit transactions under I.R.C. 4958, as well as certain amendments to existing regulations affected by I.R.C. 4958. See the 2002 CPE topic entitled "An Introduction to I.R.C. 4958 (Intermediate Sanctions)". See also the following two articles, which are on the EO web site: "Rebuttable Presumption Procedure is Key to Easy Intermediate Sanctions Compliance" and "Easier Compliance is Goal of New Intermediate Sanction Regulations".

C. T.D. 8920, 66 Fed. Reg. 13013 (March 2, 2001) Intermediate Sanctions Temporary Regulations

This document contains corrections to the recently published I.R.C. 4958 regulations. See 3.B. above.

4. Miscellaneous

National Office Service Center Advice, (SCA 2000 46038, September 27, 2000), Notice of Deficiency May Not Be Issued Without Examination

A service center cannot without an examination issue a statutory notice of deficiency when it has converted a filed Form 990 to a Form 1120 for an I.R.C. 501(c) organization that has not filed an exemption application and has refused to sign the Form 1120. This applies only where the organization is not required to file an exemption application.

5. Court Decisions

1. Robert C. Murphey Family Trust v. United States of America, 86 AFTR 2d 2000-6705 (D.C. AZ 2000)

The court dismissed for lack of jurisdiction the Trust's action filed under I.R.C. 6104 and the Freedom of Information Act (FOIA) requesting certain documents filed pursuant to a third party's private letter ruling request (PLR).

In 1998, the John and Helen Murphey Foundation filed a PLR request. In 1999, the Trust requested that the Service disclose to it the PLR request and all associated correspondence between the Service and the Foundation. In response, the Service provided the Trust only documents permitted to be disclosed under I.R.C. 6104. The Trust asked the court, under I.R.C. 6104 and FOIA, to enjoin the Service from withholding the documents.

The Service argued that the requested documents are not subject to FOIA because they concern PLR documents, the disclosure rules for which are contained exclusively in I.R.C. 6110. Additionally, the Service argued that I.R.C. 6104 is inapplicable because I.R.C. 6104 applies exclusively to exemption applications and returns. The Trust had not alleged that its disclosure request related to an exemption application. The court agreed with both Service arguments.

2. At Cost Services, Inc. v. Commissioner, T.C. Memo 2000-329 (2000)

The Tax Court upheld the Service's determination that the organization does not qualify for exemption under I.R.C. 501(a) and I.R.C. 501(c)(3).

Mr. Fondel is the founder and chief officer of At Cost Services, Inc. ("At Cost"). Mr. Fondel and At Cost are the members of At Cost LLC. At Cost LLC intended to become a "one-stop-job-center" providing job training and job placement services to the underskilled and hard to employ. At Cost and At Cost LLC often placed its client-members with temporary work agencies and also marketed Mr. Fondel's services with them. Mr. Fondel drew no salary. However, At Cost intended to pay him when its income exceeded its expenses. At Cost's income came from two sources: it requested 10 percent of gross income earned from members on jobs obtained through At Cost, and it intended to solicit donations and gifts from the local businesses that benefited from At Cost's services.

The Service issued an adverse determination on the grounds that At Cost operated for the purpose of benefiting Mr. Fondel, and that it failed to show that it is operated exclusively for exempt purposes. The court upheld both determinations, noting that the taxpayer's activities were indistinguishable from those of a temporary service agency.

3. Quality Auditing Company, Inc. v. Commissioner, 114 T.C. 498 (2000)

The Tax Court upheld the Service's denial of charitable status to a nonprofit corporation organized to audit structural steel fabricators under a quality certification program. The court agreed with the Service that the organization furthered private interests and therefore was not operated exclusively for charitable purposes.

Quality Auditing Company, Inc. (QAC) was organized to provide a uniform reliable certification program for the American Institute of Steel Construction, Inc. (AISC), an organization described in I.R.C. 501(c)(6). AISC, with some government collaboration, developed a standardized engineering code and specifications for use in the fabrication and construction of steel-framed buildings and bridges. This standardization facilitated an ability to inspect the quality control procedures that steel fabricators used when fabricating steel components. Inspection of these procedures and subsequent certification provided a reliable method for selecting a competent fabricator during the construction bidding process. Some governmental agencies requested such standardization. AISC eventually trademarked the code and specifications to the AISC Quality Certification Program. Under the Program, a company contacts AISC to be certified. AISC then contracts and pays an independent entity to perform the actual audit investigation. AISC initially used a private, for-profit company to conduct the facility audits, but eventually decided to provide the start-up capital to establish QAC as an independent, non-profit corporation because of the specialization needed for this kind of audit. Substantially all of QAC's time and resources are devoted to performing the quality audit function for AISC and there is no other entity that presently provides this service.

QAC claimed that its audit function reduced the burdens of government and that it encouraged safe construction for the benefit of the general public.

The court held that QAC furthers a not insubstantial private interest and thus is not operated exclusively for exempt purposes. The court noted that there is no indication that a governmental unit considered it to be its burden to inspect or certify control procedures of private steel fabricators. Governmental agencies were among those who initially requested the AISC develop a certification program and have made use of the program. However, there was no showing that the governmental units view a program for auditing steel fabricators as a governmental responsibility.

Further the court found nothing in QAC's literature on the auditing process to suggest that the process was designed to promote safety. It found the process was designed to further goals of AISC and the steel fabrication industry. Safety issues were secondary. The court found the certification process substantially furthered private purposes.

4. Music Square Church v. United States, 218 F.3rd 1367 (Fed. Cir. 2000)

The Federal Circuit affirmed the denial by the Court of Federal Claims of Music Square Church's (MSC) motion for summary judgment. MSC had argued that the IRS's final adverse determination letter was void as untimely under I.R.C. 7611(c)(1).

The Service initiated its church tax inquiry of MSC in December 1989 and issued the final adverse determination letter in April 1996. MSC filed a petition for declaratory relief under I.R.C. 7428 challenging the revocation because of the IRS's failure to comply with I.R.C. 7611(c)(1)(A), which provides that Service "shall complete any church tax status . . . examination . . .not later than the date which is 2 years after the examination notice date." The court's opinion was based on its view that the I.R.C. 7611(c)(1) two-year limit is goal-oriented or merely precatory (i.e., a wish rather than a requirement) in effect, and that Congress did not intend the two-year limit to be mandatory. The court held that I.R.C. 7611(e)(2) precluded MSC's suit by providing exclusive remedies for the Service's procedural failures with respect to I.R.C. 7611. The court, however, did not uphold the Service's contention that MSC was engaged in a willful attempt to evade income tax under I.R.C. 7611(i), the effect of which would have been to remove MSC from the protections of I.R.C. 7611 altogether.

5. Sherwin-Williams Company Employee Health Plan Trust, et al. v. Commissioner, 115 T.C. 440 (2000)

The Tax Court upheld the Service's position on the amount of exempt function income under I.R.C. 512(a)(3)(B) that can be excluded from unrelated trade or business income tax.

The taxpayer, herein "Trust", is exempt under I.R.C. 501(c)(9). It set aside funds along with its investment income to pay health claims and related administrative expenses, and it funded a reserve for post-retirement health benefits. The Trust argued that set-asides for reasonable administrative costs under I.R.C. 512(a)(3)(B) were not subject to the account limit limitations of I.R.C. 419A and I.R.C. 512(a)(3)(E). The court rejected this position. The Trust also argued that the provision in I.R.C. 512(a)(3)(E) that reduces the account limit by any post-retirement medical reserve should also be interpreted to require an equivalent reduction in the amount of taxpayer's assets set aside under I.R.C. 512(a)(3)(B). The court rejected this position as well.

6. The Nationalist Foundation v. Commissioner, 80 T.C.M. 507 (2000)

The Tax Court, in an I.R.C. 7428 action, upheld the Service's denial of recognition of charitable status to the taxpayer.

The taxpayer's constitution stated that it was dedicated to advancing American freedom, American democracy, and American nationality. The court noted that much of the organization's publicly available material contained several distortions of fact and that the organization declined repeated IRS requests to include other educational material in the administrative record. The organization intended to act as a private attorney general to litigate against those who disrupt "pro-majority" demonstrations; it would file legal briefs to support "[pro-majority minded] Americans" and use 42 U.S.C. § 3604(e) to "save" neighborhoods by suing incoming minorities.

The organization filed its Form 1023 requesting recognition of exemption under I.R.C. 501(c)(3). When the Service raised objections to certain aspects of the application, the organization sought to withdraw the objectionable material. The Service denied the organization's claim to exemption. At Tax Court, the taxpayer argued that it was described in I.R.C. 501(c)(3) because it operated for charitable and educational purposes. It further argued that the Service's refusal to recognize the exemption of the organization was a violation of the organization's right to equal protection under the laws.

As an initial matter, the court noted that the organization, during the information development stage of the application process, has countermanded and withdrawn so much of the administrative file that the remaining file before the court was skeletal.

Under Bubbling Well Church v. Commissioner, 74 T.C. 531, 535 (1980), aff'd 670 F.2d 104 (9th Cir. 1981), the court inferred missing facts against the applicant organization.

The court upheld the Service's denial because the remaining facts did not support recognition of exemption. Relying on Treas. Reg. § 1.501(c)(3)-1(d)(2) the court stated that lessening neighborhood tensions provided some insight into the meaning of charitable and held that the organization's activities were antithetical to the regulations' definition of "charitable." Neither did the organization further educational purposes. The court relied on the methodology test of Rev. Proc. 86-43, 1986-2 C.B. 729, which provides that if the organization's viewpoints purport to be supported by facts, and those facts are distorted, the organization may not be found to promote educational purposes.

The organization's discovery motion filed in furtherance of its constitutional arguments was denied. The court noted that under Nationalist Movement v. Commissioner, 37 F.3rd 216, 218-219 (5th Cir. 1994), the Tax Court will only consider matters outside the administrative record "in very unusual circumstances and upon good cause shown". The court ruled that the organization had failed to present sufficient factual predicate to consider matters outside the administrative record.

7. Abraham Lincoln Opportunity Foundation v. Commissioner, 2000 T.C.M. 261 (2000)

The Tax Court dismissed the Abraham Lincoln Opportunity Foundation's (ALOF) I.R.C. 7428 action for lack of jurisdiction.

The Service revoked ALOF's exemption under I.R.C. 501(c)(3) in 1998. ALOF had already dissolved in 1995 under Colorado law, retaining no property. In 1999, ALOF filed an I.R.C. 7428 declaratory judgment action. The court dismissed the case despite ALOF's argument that it was organized under Colorado law, which allows actions to be maintained on behalf of dissolved non-profit corporations. The court noted that Colorado nonprofit law allows only two years for such suits to be maintained unless the dissolved entity retains real property. ALOF did not claim in its petition that it had retained any property. ALOF filed its suit after the relevant Colorado statutory period had expired. The court dismissed the case for lack of subject matter jurisdiction.

8. Redlands Surgical Services v. Commissioner, 242 F.3rd 904 (9th Cir. 2001)

In a short per curiam opinion, the Ninth Circuit affirmed the Tax Court's opinion ruling that the taxpayer was not described in I.R.C. 501(c)(3).

The taxpayer had a noncontrolling interest in a partnership with a for-profit entity. The partnership acquired a majority interest in an outpatient surgical center. An affiliate of the for-profit entity managed the surgical center's daily operations. The taxpayer had no other charitable program or purpose. In Redlands Surgical Services v. Commissioner, 113 T.C. 47 (1999), the Tax Court upheld the Service's determination that the organization was not described in I.R.C. 501(c)(3).

The court adopted the Tax Court's holding that the taxpayer had ceded effective control over the partnership and the surgical center to private parties, conferring impermissible private benefit on those parties. The court also affirmed the Tax Court's conclusion that the benefit conferred on private parties by the surgical center's operations prevented the taxpayer from attaining tax exempt status under the integral part doctrine. Taxpayer's request for a rehearing was denied.

See the 2002 CPE "Health Care Update" topic for further discussion.

9. Branch Ministries and Dan Little, Pastor v. Commissioner, 211 F.3rd 137 (D.C. Cir. 2000)

The D.C. Circuit affirmed the district court's summary judgment, which upheld the Service's revocation of a church's exemption because of the church's political activities.

Branch Ministries operates the Church at Pierce Creek ("Church"). In 1983, the Church requested and received a letter from the Service recognizing its tax-exempt status. In 1992, the church expressed its concern about the moral character of a candidate for national-level public office. An advertisement, with solicitations for tax-deductible contributions, was placed in two newspapers with wide national circulation shortly before the election.

The Service revoked the organization's exemption. The organization filed a timely action challenging the revocation on the following three grounds: the Service lacked the authority to revoke the a church's exemption from federal income tax; the Service violated the church's right to free speech and to free exercise its religion under the First Amendment and the Religious Freedom Restoration Act of 1993; and the Service violated the church's Fifth Amendment protections from selective prosecution.

The court held that the Service had the authority under I.R.C. 7611 to revoke recognition of the Church's I.R.C. 501(c)(3)'s status.

On the organization's First Amendment arguments, the court ruled that the Church failed to make the threshold showing that the government's action, withdrawal of a conditional privilege, was a constitutionally substantial burden. The court noted that the Church can form an I.R.C. 501(c)(4) organization, which can use an I.R.C. 527(f) separate segregated fund to communicate political ideas.

On the selective prosecution argument, the court stated that in the absence of clear evidence to the contrary, courts presume the government prosecutors have properly discharged their official duties. The court used the selective prosecution test stated in United States v. Washington, 205 F.2d 489, 494 (D.C. Cir 1983), wherein the allegations must establish both that the person was singled out for prosecution from among others similarly situated, and that the prosecution was improperly motivated. The court found that the Church has failed the threshold showing there was any similarly situated person that had engaged in the same conduct. As such, the court did not need to reach the question of whether the IRS was improperly motivated.

6. Legislation of the 107th Congress (1st Session)

A. Pub. L. No. 107-16, Economic Growth and Tax Relief Reconciliation Act of 2001

Section 402(a) amends I.R.C. 529(b)(1) to expand the definition of a qualified tuition program to include programs established and maintained by one or more eligible educational institutions (institutions of higher learning as defined in I.R.C. 529(e)(5)). Under existing law, qualified tuition programs were restricted to those sponsored by states and their agencies and instrumentalities. The new nongovernmental programs must hold assets in a qualified trust and must have received a ruling or determination that they meet the requirements for a qualified tuition program. Amounts are to be used for purchasing tuition credits or certificates on behalf of a designated beneficiary that entitle beneficiaries to a waiver of qualified higher education expenses. A qualified trust for this purpose is a domestic trust for the exclusive benefit of designated beneficiaries that meets the trustee and investment requirements of I.R.C. 408(a)(2) and (5).

Section 402(b) amends I.R.C. 529(c)(3)(B) to provide that cash distributions from any qualified tuition program would be excludible from gross income of the beneficiary to the extent the distributions do not exceed the qualified higher education expenses. In-kind distributions (i.e., tuition credits) are excludible if the benefit would be a qualified higher education expense. These provisions are effective for taxable years beginning after December 31, 2001 for state-sponsored programs, and for taxable years beginning after December 31, 2003 for non-governmental programs.

Section 402(c) amends I.R.C. 529(c)(3)(C) to permit an inter-program rollover on behalf of the same beneficiary. This rollover may be made between two qualified tuition programs, and only one rollover is permitted in a twelve-month period.

Section 402(d) amends I.R.C. 529(e)(2) to include in the definition of "member of the family" on whose behalf a contributor can change a designated beneficiary, a designated beneficiary's first cousin.

Section 402(e) amends I.R.C. 529(e)(3)(B) to increase, in certain cases, the funds that are qualified higher education expenses attributable to room and board.

Generally, the provisions of Act section 402 apply to taxable years beginning after December 31, 2001. With respect to non-governmental qualified tuition programs, the distributions provisions only apply in taxable years beginning after December 31, 2003.

B. P.L. 106-554

Section 312 amends I.R.C. 6104(d) to require disclosure of returns filed under I.R.C. 6033(d)(1) and (2). I.R.C. 6033(d)(1) provides the filing requirement for nonexempt charitable trusts and I.R.C. 6033(d)(2) provides the filing requirement for nonexempt private foundations.