K. FUND-RAISING UPDATE

1. Article Overview

This article is an update of the 1989 CPE article, Special Emphasis Program - Charitable Fund-Raising. That article outlined the developments that led to the initiation of the Special Emphasis Program. Since one of the concerns that led the Service to initiate the program was the quality of the information that some charities were giving contributors about tax deductibility, the article discussed the basic rules governing deductibility under IRC 170 as spelled out in Rev. Rul. 67-246.

In addition to the basic rules governing the deductibility of contributions, the article discussed several issues relating to exemption under IRC 501(c)(3), that are often encountered in fund-raising cases. These issues included:

(a) The "commensurate" test - whether a charitable organization whose principal activity is fund-raising is distributing enough either in grants or program expenditures, and

(b) Inurement to insiders - whether certain contingent compensation arrangements involving fund-raising organizations violate the prohibition against inurement.

Part 2 of this article will discuss a recent Supreme Court decision that upholds the quid pro quo analysis of Rev. Rul. 67-246. It will also discuss a number of revenue rulings under IRC 170 that apply the rules of Rev. Rul. 67-246 to specific factual situations and it surveys the case law based on the revenue ruling. Finally, it discusses several recent cases that discuss other fund-raising issues. Part 3 summarizes several Service publications that affect the Special Emphasis Program. Part 4 updates the discussion of exemption issues encountered in fund-raising cases.

2. IRC 170 Issues

a. Hernandez v. Commissioner, 490 U.S.__ ; reprinted in 1989-37 I.R.B. 4

The 1989 CPE article discussed the 1986 Supreme Court decision in the American Bar Endowment case that affirmed Rev. Rul. 67-246. In June of 1989, the Supreme Court handed down another decision that touched on the rules discussed in that revenue ruling.

One of the basic principles of Rev. Rul. 67-246 is that to be deductible as a charitable contribution, a payment to a charity must be a gift, that is, a voluntary transfer of money or other property that is made with no expectation of procuring a financial benefit commensurate with the amount of the transfer. Where consideration in the form of substantial benefits is received in connection with payments by patrons of fund-raising activities, there is a presumption that the payments are not gifts, and that the total amount paid represents the fair value of the benefits received in return or in legal terms - a quid pro quo.

Whether a taxpayer has received consideration in return for a contribution has frequently been an issue when a payment has been made to a church. The Service had taken the position that there are certain payments made to a church that do not involve consideration and that are deductible as charitable contributions. See Rev. Rul. 70-47, 1970-1 C.B. 49.

In Hernandez v. Commissioner the Supreme Court decided that the fees paid to the Church of Scientology for auditing and training were not deductible because there was a quid pro quo, i.e., auditing and training in exchange for payment. The Supreme Court's decision affirmed the position taken by the Service in Rev. Rul. 78-189, 1978-1 C.B. 68.

In Hernandez, the taxpayers argued that, as a matter of statutory interpretation, the rule - basic to Rev. Rul. 67-246 - that to be deductible as a charitable contribution, a payment to a charity must be made with no expectation of procuring a benefit commensurate with the amount of the payment - was not applicable when a payment was made to secure a religious benefit. The Court rejected this argument, stating:

> Numerous forms of payments to eligible donees plausibly could be categorized as providing a religious benefit or as securing access to a religious service. For example, some taxpayers might regard their tuition payments to parochial schools as generating a religious benefit or as securing access to a religious service; such payments have long been held not to be charitable contributions under [IRC] 170.

The taxpayers also argued a number of constitutional issues. Their principal argument was grounded in the free exercise clause. The taxpayers claimed that the free exercise clause was violated by placing a heavy burden on the central practice of Scientology which as a fundamental doctrine holds that payment has to be received for religious services rendered. The Court makes the following analysis in deciding against the free exercise clause argument:

> In any event we need not decide whether the burden of disallowing the section 170 deduction is a substantial one, for our decision in [United States v. Lee 455 U.S. 252 (1982)] establishes that even a substantial burden would be justified by the "broad public interest maintained in a sound tax system," free of "myriad exceptions flowing from a wide variety of religious beliefs." 455 U.S. at 260. In Lee we rejected an Amish taxpayer's claim that the Free Exercise Clause commanded his exemption from Social Security tax obligations, noting "[t]hat the tax system could not function if denominations were allowed to challenge the tax system" on the ground that it operated "in a manner that violates their religious belief." Ibid. That these cases involve federal income taxes, not the Social Security system, is of no consequences. Ibid. The fact that Congress has already crafted some deductions and exemptions in the Code also is of no consequence, for the guiding principle is that a tax "must be uniformly applicable to all, except as Congress provides explicitly otherwise." Id., at 261. Indeed, in one respect, the Government's interest in avoiding an exemption is more powerful here than in Lee; the claimed exemption in Lee stemmed from a specific doctrinal obligation not to pay taxes, whereas petitioners' claimed exemption stemmed from the contention that an incrementally larger tax burden interferes with their religious activities. This argument knows no limitation. We accordingly hold that petitioner's free exercise challenge is without merit.

Finally, the Court disposed of the question of whether the payments were partially deductible under Rev. Rul. 67-246 by noting that the issue did not need to be decided since the taxpayer had failed to raise it in a timely manner.

b. The Offspring of Rev. Rul. 67-246

There are a number of revenue rulings, issued after 1967, that build on the analysis contained in Rev. Rul. 67-246. A brief description of each of these revenue rulings follows:

1. Rev. Rul. 68-432, 1968-2 C.B. 104

This revenue ruling discusses the deductibility of membership contributions to charitable, educational, scientific, or literary organizations when the membership fee is out of proportion to the benefits received. If any reasonably commensurate return, privileges, or facilities are made available by reason of the membership payment, the payment is not a charitable contribution within the meaning of IRC 170.

2. Rev. Rul. 74-348, 1974-2 C.B.

This revenue ruling has a more narrow focus. The holder of a season ticket donated a ticket to one performance to a charitable organization for resale. The taxpayer's deduction was limited to the pro rata cost of the ticket rather than the higher individual ticket price. Rev. Rul. 67-246 was distinguished. In Rev. Rul. 67-246 it was stated that an individual who had purchased a ticket as a charitable gesture with no intent to use it could not take a deduction. Here, the taxpayer had absolutely relinquished the right to admission and thus was entitled to the deduction.

3. Rev. Rul. 76-185, 1976-1 C.B.

While this revenue ruling does not cite Rev. Rul. 67-246, it discusses the presumption that a payment is not a gift where the payor receives value in return for a payment. In this case a taxpayer finances the restoration and maintenance of a state-owned historic mansion. In return the taxpayer receives the right to live in the mansion for 15 years. Unless the taxpayer can show that the benefits received are not commensurate with the payments for financing and maintenance, no part of the payments is deductible as a charitable contribution under IRC 170. This revenue ruling is significant because, for the first time, the Service took the position that to trigger the presumption that a payment was not a gift, the benefit received had to be of "substantial" value.

4. Rev. Rul. 76-232, 1976-1 C.B.

This revenue ruling concerns the deductibility of fees paid for a weekend marriage seminar conducted by a charitable organization. It has wider interest because it discusses the broader issue of the deductibility of fees paid for services rendered by charitable organizations. It relies on Rev. Rul. 67-246 for the general rule that where a transaction involving a payment is in the form of a purchase of an item of value, the presumption arises that no gift has been made for charitable contribution purposes, the presumption being that the payment in such case is the purchase price. It also demonstrates that in some circumstances payments may be nondeductible even though they are not strictly mandatory.

5. Rev. Rul. 78-189, 1978-1 C.B.

This revenue ruling deals with the deductibility of "fixed donations" paid to the Church of Scientology for general education courses, religious education courses, and "auditing and processing" courses. (As indicated above, this issue was the subject of the Supreme Court decision in the Hernandez case.) The ruling concluded that the taxpayer is not entitled to a charitable contribution deduction for any part of the "fixed donation" made to the church unless the taxpayer can establish that the "fixed donation" exceeded the fair market value of the benefits and privileges received. The deduction would be limited to the excess.

6. Rev. Rul. 79-81, 1979-1 C.B. 107

This revenue ruling concerns the deductibility of payments made to a theological college to "sponsor" the religious leadership training of an individual. The sponsor claimed that the contributions were to the college in general. The ruling concludes that the payments are not deductible because they are not distinguishable from normal tuition payments. The ruling relied in part on the manner in which the payments were made. The payments were forwarded on a form which indicated the name of the person who solicited the payment and further indicated the student the payment supported.

7. Rev. Rul. 80-286, 1980-2 C.B. 179

This revenue ruling concerns both exemption under IRC 501(c)(3) and the deductibility of contributions made to a particular organization. The organization arranged for the temporary exchange of students between the U.S. and foreign countries. The ruling concluded that the organization was described in IRC 501(c)(3) of the Code. The ruling also concludes the fees paid by parents of participants will not be considered as deductible charitable contributions unless they exceed the fair market value of the services received. This is very difficult to prove because there is a presumption that the payments were at fair market value.

8. Rev. Rul. 83-104, 1983-2 C.B. 46

This revenue ruling uses factual situations to illustrate the distinction between qualified charitable contributions and tuition payments made to an organization that operates a private school. In determining this issue, the presence of one or more of the following factors creates the presumption that a payment is not a charitable contribution: the existence of a contract under which a taxpayer agrees to make a "contribution" and which contains provisions ensuring the admission of the taxpayer's child to a school; a plan allowing the taxpayers either to pay tuition or to make "contributions" in return for schooling; the earmarking of a contribution for the direct benefit of a particular individual; or the otherwise-unexplained denial of admission or readmission to a school of children of taxpayers who are financially able, but do not contribute.

In other cases, although no single factor may be determinative, a combination of several factors may indicate that a payment is not a charitable contribution. In these cases, both economic and noneconomic pressures placed upon parents must be taken into account. The factors the Service ordinarily will take into consideration (but not limit itself to), are the following: the absence of a significant tuition charge; substantial or unusual pressure to contribute applied to parents of children attending a school; contribution appeals made as part of the admissions or enrollment process; the absence of significant sources or potential sources of revenue for operating the school other than contributions of parents; and other factors suggesting that a contribution policy has been created as a means of avoiding the characterization of payments as tuition.

If a combination of these factors is not present, payments by a parent will normally constitute deductible contributions, even if the actual cost of educating a child exceeds the amount of tuition charged for the child's education.

9. Rev. Rul. 83-130, 1983-2 C.B. 148

This revenue ruling discusses the tax consequences of the sale of a personal residence through a raffle conducted by a charitable organization. The homeowner granted the charitable organization an option to purchase his house for a stated sum. The charity was to raise the purchase price plus at least $ 20,000 profit for itself. The charity actually raised twice the purchase price of the house from this lucrative fund raiser. The following conclusions were reached in the revenue ruling.

a. The purchasers of losing raffle tickets did not make charitable contributions because they received value, the right to compete for a valuable prize. It may be treated as a wagering loss to the extent of wagering gains.

b. The winner must include the value of the house less the cost of the ticket in income as gambling winnings.

c. The homeowner has long term capital gain (pre-1986 treatment) of the purchase price minus the basis.

d. The homeowner is not entitled to a charitable deduction.

10. Rev. Rul. 86-63, 1986-1 C.B. 88

This revenue ruling outlines the pre-Omnibus Budget Reconciliation Act (OBRA) rules concerning the deductibility of payments to athletic scholarship programs when the payments afford a right to purchase preferred seating at athletic events. A number of situations are discussed, in some a charitable contribution was permitted. The general rule enunciated is that a taxpayer will have made a charitable contribution only if, and only to the extent that the payment made exceeded the value of any substantial privileges or benefits afforded by membership in the program. The rules concerning the deductibility of these payments is now governed by IRC 170(m). IRC 170(m) was enacted in OBRA and was retroactive to 1984.

11. Rev. Rul. 89-51, 1989-15 I.R.B. 5

This revenue ruling concerns the donation by the owner to a charitable fund-raising auction of the right to use a vacation home for one week. The principal focus of the ruling is the treatment of transaction for purposes of IRC 280A(d) which affects the ability of a property owner to deduct rental expenses if the property is used for personal use. But, the ruling also discusses the IRC 170 issue. The owner is not entitled to a charitable contribution because the gift of the right to use property does not give rise to a deductible contribution. See Reg. 1.170A-7(a)(1) for rules concerning the nondeductibility of partial contributions of the donor's interest in property. The purchaser of the vacation week is not entitled to a deduction because value was received.

c. Rev. Rul. 67-246 in the Courts

A number of court decisions have relied on Rev. Rul. 67-246 for rationale. The most significant of these decisions, United States v. American Bar Endowment, 477 U.S. 105 (1986) was discussed in last year's CPE article. Other cases that cite Rev. Rul. 67-246 include:

Ryan v. Commissioner. 28 TCM 1120 (1969), concerns the denial of charitable contribution deductions for various payments made to churches and parochial schools. The court stated that to be allowable as charitable deductions under IRC 170, petitioners must establish that the amounts in dispute were paid to qualified charitable organizations as gifts. Such amounts may not be used for personal, living or family expenses. As the cost of educating a child is a personal expense, the amounts paid to parochial schools were disallowed. The taxpayer had paid $100 both as a contribution to an athletic fund and in payment for football tickets. The payment to the athletic fund was allowed. Citing Rev. Rul. 67-246, the court concluded that the payments for tickets were not deductible as value was received. Payments made for a church hall and an organist for a child's wedding were also disallowed as personal expenses.

Murphy v. Commissioner, 54 TC 249 (1970), concerns the deductibility of payments made to an adoption agency. The adoption agency originally had a policy of not requiring payment for adoption services but encouraging contributions. Prior to the adoption of the taxpayers' daughter, the policy had been changed to require the adoptive parents to contribute 10% of their gross income. The taxpayers were not informed of this change and they understood that the amount they paid was voluntary. Relying, in part, on Rev. Rul. 67-246, the Court concluded that the payments were not deductible. The characterization of the payments by the adoption agency was not relevant. What was relevant was that the taxpayers received value, the services of the agency, in exchange for their payment. The taxpayers could have argued that they overpaid because their payment was not calculated on the basis of the cost of the adoption to the agency. Since they did not make the argument that their payment exceeded the value received, the entire contribution was disallowed.

Nelson v. Commissioner. 33 TCM 1057 (1974), concerns a number of issues. The 86 year old taxpayer had not filed income tax returns for over 20 years. Most of the issues in the case involve reconstruction of the taxpayer's income during that period. In addition, the taxpayer claimed substantial charitable deductions. He claimed a deduction for the value of his stamp collection although he had not donated it to a charitable organization. He apparently felt that the fact that he bought stamps and retained them without using them should be considered a contribution to the federal government. The court relied in part on Rev. Rul. 67-246. An analogy was made to tickets that are purchased but not used. While the taxpayer did not use the stamps, he had the right to use them, which is considered a valuable right.

d. Recent Cases Concerning the Deductibility of Contributions

Several recent court decisions have involved IRC 170 issues that, while not related to the central issues of Rev. Rul. 67-246, are of interest because they involve issues frequently found in fund-raising cases.

In Kessler v. Commissioner, 87 T.C. 1285 (1986), petitioner had claimed a charitable contribution for his expenses incurred in a trip taken with his wife to Puerto Rico. The petitioner believed in worshipping the sun god or gods, which had to be performed in the tropics. The taxpayer did not make contributions to an organization described in IRC 501(c)(3), he attempted to deduct personal expenses incurred in traveling to worship the sun god. The petitioner conceded that these expenses were not deductible under the "IRS interpretation" of IRC 170. He argued, however, that IRC 170 was unconstitutional because it only permitted deductions to organizations, not the deduction of individual expenses. The Court found that the statute did not discriminate against the petitioner's exercise of religion. In addition the Court found that the taxpayer did not have standing to test the constitutionality of the provision because, if the statute was found unconstitutional, there would be no basis for the petitioner's deduction.

In Allen v. Commissioner, 92 T.C. 1 (1/5/89) the taxpayer claimed a $25,000 charitable deduction for amounts paid to an organization exempt under IRC 501(c)(3). The taxpayer was party to a creative fund-raising scheme on the part of one Gordon Bizar and the corporations he created. International Business Network was exempt under IRC 501(c)(6). In order to receive deductible contributions, Bizar created National Institute for Business Achievement. The

National Diversified Funding Corporation is a for-profit corporation owned 60% by IBN and 40% by Bizar. The fund-raising scheme involved moving money around in a closed circle and counting it as a charitable contribution every time it passed through the hands of the charity. The individual taxpayer would make a contribution to NIBA. The contribution would consist of 10% of the individual's own funds and a 90% low interest loan from NDF, the for-profit. The funds for NDF to make the loans came from a loan from the 501(c)(3) organization to the 501(c)(6) organization. The Court concluded that no contribution had been made because the charity was just receiving its own money back. The rule is that the charity has to receive the gift and the gift has to have value. In this case, there was no benefit received by the charity from 90% of the purported contribution. The taxpayer attempted to rely on Rev. Rul. 78-38 which holds that contributions made by credit cards are deductible in the year the charge is incurred. The Court concluded that the three Bizar controlled entities worked as a functionally integrated whole and as a consequence the transaction was not at arm's length. The case could prove useful in a number of areas where benefits are flowing between related entities.

3. Service Publications, etc.

a. Announcement 89-138, 1989-45 I.R.B. 41

The purpose of Announcement 89-138 is to remind exempt organizations that income from the public conduct of bingo and other gambling activities may be subject to the unrelated business income tax imposed by IRC 511(a).

Frequently, tax exempt organizations have been involved in conducting bingo and other games of chance such as pull tabs, raffles, video games, poker, 21, punch board, and lotteries for the public. Conduct of these games has been a means of raising funds to carry on their exempt activities. The organizations that have, historically, engaged in these activities include: charities described in IRC 501(c)(3); social welfare organizations described in IRC 501(c)(4); social and recreational organizations described in IRC 501(c)(7); fraternal organizations described in IRC 501(c)(8) or (10); and, veterans organizations described in IRC 501(c)(19).

With more and more tax exempt organizations getting involved in this industry, the Service used Announcement 89-138 to express its concern with the level of the noncompliance of some organizations with the unrelated business income tax provisions and to advise organizations that it would be reviewing the gambling activities of tax exempt organizations as part of its Special Emphasis Program on Fund-Raising Activities.

Since changes to the unrelated business income tax provisions applicable to bingo and other gambling activities might have created confusion for tax exempt organizations, the Announcement will recapped the UBIT rules applicable in this area.

b. Technical Advice Memoranda 8832002 and 8909004

Technical Advice Memorandum 8832002 has been the subject of further discussion in the National Office and additional guidance has been issued to the District Director concerning this taxpayer in Technical Advice Memorandum 8909004. The taxpayer was engaged in arranging interchanges between U.S. professionals and their foreign counterparts. Professionals and their spouses and children participated. The taxpayer informed the participants what portion of their payments would be business and charitable deductions. The taxpayer's formulation was not consistent with Rev. Rul. 67-246. Issue one in the original memorandum was whether the taxpayer could be revoked for its erroneous advice. The second issue was to what extent the tours generated unrelated business taxable income. The memorandum concluded that the erroneous advice was not a ground for revocation. It also concluded that the payments made on behalf of spouses and children would be subject to unrelated business income tax. The second memorandum questions, fundamentally, whether the organization is engaging in an exempt activity because of the social and recreational nature of its tours. It also recommends further examination and coordination with the Examination Division on the deductibility issues.

4. Commensurate Test and Inurement of Income

a. The "Commensurate" Test

The 1989 CPE article discussed several issues, involving exemption under IRC 501(c)(3), that are common in many fund-raising situations. One of these issues, the satisfaction of the "commensurate test" involves organizations that raise funds for charitable purposes by conducting an activity that is not itself charitable.

Two typical examples are organizations that conduct bingo games or golf tournaments and turn over the proceeds to charity.

Pared down to the essentials, the only appropriate reason for recognizing the exemption of these organizations under IRC 501(c)(3) lies in their ability to generate funds for charity. (Whether or not these organizations are subject to the unrelated business income tax is another question. See Topic K, Gambling Activities of Exempt Organizations).

In Make a Joyful Noise, Inc. v. Commissioner, 56 T.C.M. 1003 (1989), the Court concluded that the petitioner was not described in IRC 501(c)(3). The petitioner was organized in order to operate a camp for disadvantaged children and elderly citizens. While the organization maintained this goal, during its more than five years of operation, no progress was made towards its accomplishment. Initially the organization conducted its own bingo games. In response to a change in state law, the organization conducted bingo games on behalf of other organizations. The Court found that the petitioner was principally engaged in the conduct of bingo games. The Court did not place any reliance on the organization's charitable goals when the evidence showed that no progress had been made towards the achievement of those goals.

b. Inurement of Earnings and Private Benefit

Last year's CPE article discussed the related questions of inurement and private benefit as central issues in fund-raising cases. Many abuse cases have common elements. A typical situation involves a "charity" or a "social welfare organization" that is created by officers or employees of a professional fund-raiser. The new exempt organization then hires the fund-raiser to conduct one or more solicitation campaigns. Typically, the exempt organization ultimately receives less than 20 percent (sometimes zero) of the gross contributions received through the solicitation campaign, with the bulk of the contributed funds going to the fund-raiser as a fee for its services and for actual expenses of the solicitation campaign (printing, postage, mailing list rental, etc.). Sometimes a related corporation does the printing or rents the mailing list to the fund-raiser. The fund-raiser and related corporations end up making substantial profits while the exempt organization receives little or nothing. There have been several instances in which solicitation campaigns generated hundreds of thousands of dollars of contributions, but the exempt organization ended up owing money to the fund-raiser.

When the exempt organization does receive some funds, they are usually expended in the form of small grants to unrelated legitimate charities. In the next-to-worst cases, the only educational or other exempt activity conducted by the exempt organization takes the form of perfunctory "educational" material distributed with the solicitation for contributions. In the worst cases, no exempt activities at all are conducted. Many of these solicitations take the form of sweepstakes or other types of contests in which respondents can win merchandise or cash prizes.

Where the exempt organization and the fund-raiser are related parties, an abuse may exist and the exempt organization may be serving private interests even though the fees the exempt organization pays the fund-raiser are at the prevailing rates within the industry for similar services. The exempt organization does not have to be overcharged for an abuse to be present, but evidence of overcharges would significantly strengthen an adverse position against a particular organization.

Similarly, where prevailing rates are paid and substantially all of the gross fund-raising proceeds are retained by, or paid to the fund-raiser, but the exempt organization and the fund-raiser cannot be shown to be related parties (that is, it cannot be shown that the exempt organization was created by officers or employees of the fundraiser or that they were instrumental in creating the exempt organization), an abuse situation may well be present. It may or may not be true that the exempt organization was created with the intent to benefit private interests, but in actual operation the organization's fund-raising activities have done just that.

In both situations, any benefit to the public from the exempt organization's activities will almost always be insubstantial, in some cases nonexistent. Service personnel should strongly argue that point in appropriate instances.

It is important to distinguish between an abuse by design (intended abuse) case from a situation in which a legitimate exempt organization had an unsuccessful fund-raising campaign conducted by an unrelated fund-raiser. The following factors, if present, may be indicative of intended abuse where fund-raising expenses consume substantially all of the contributions received from a fund-raising campaign:

(1) The exempt organization does not conduct any exempt activities itself, but merely makes grants to other organizations or claims that it intends to do so when funds are available, or

(2) The exempt organization's primary exempt activity (excluding any grants it might make) consists of educating the public via material included with a solicitation for contributions.

The longer an exempt organization has operated in this manner without any significant identifiable public benefit, but with substantial benefit to a fund-raiser, the stronger the case for private benefit as grounds for revocation or denial of initial recognition of exemption.

There are a number of new cases on these issues which are briefly discussed below. While many of these cases involve mail order ministry cases, they are useful in any case where there is a question of whether those in control of the organization benefitted, to an impermissible extent, from their association with the organization.

In <u>International Postgraduate Medical Foundation v. Commissioner</u>, T.C. Memo 1989-36 (1989), the Court concluded that the petitioner was not described in IRC 501(c)(3). The petitioner was organized for the purpose of providing continuing medical education to physicians. To this end, it took physicians on three week tours throughout the world. The petitioner shared offices with a for-profit travel agency which was controlled by the petitioner's principal officer. It made all its travel arrangements through the agency.

The Court found that a substantial purpose of the petitioner was benefitting the for-profit travel agency. It concluded that:

> When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of [IRC] 501(c)(3), even if it furthers other exempt purposes.

The Court also found that the tour activities served a substantial recreational purposes. This was used as another basis for denying exemption.

> The regulations and cases clearly contemplate that a single activity may be carried on for more than one purpose. If a substantial secondary purpose is not an exempt one, qualification under [IRC] 501(c)(3) will be denied.

In Good Friendship Temple v. Commissioner, T.C. Memo 1988-313 (1988), the Tax Court concluded that the petitioner church should not be recognized as an organization described in IRC 501(c)(3). The petitioner was controlled by three directors and, apparently, these three directors comprised the entire congregation. The organization's president contributed his entire salary from outside employment. In return, most of his living expenses were paid by the church. The Court stated that control by a self-perpetuating group may not in itself disqualify an organization but it presents opportunities for abuse. While the organization claimed that the payments on behalf of its president were fair compensation, the Court concluded that he had not rendered services sufficient to merit his receipt of the entire net income of the organization. This can be a very useful case in the fund-raising area because fund-raising organizations are often tightly or family controlled.

In Anthenagoras I Christian Union of the World, Inc. v. Commissioner, T.C. Memo 1988-196 (1988), the Tax Court also concluded that the petitioner was not described in IRC 501(c)(3) of the Code. The principal officer had contributed his residence to the organization and was still living in the house. The Court did not solely rely on the contribution to conclude that the organization was operating for the private interests of its creators. The fact that the organization's activities changed at the whim of its principal officer indicated that the organization was operating for his benefit.

In Universal Church of Jesus Christ, Inc. v. Commissioner, T.C. Memo 1988-65 (1988), the Tax Court agreed with the Service, that revocation of the organization's exemption as an organization described in IRC 501(c)(3) was merited. While inurement to the principal officers existed, it was the least of the organization's problems. The organization was operating a number of commercial business, none of which were run reputably. The extent of the commercial activity was so substantial that the organization's religious activity was found to be, on its face, insignificant. It is an interesting case because it demonstrates that, at a certain level, commercial activity can overpower exempt activities.

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1990 UPDATE
Editor's Note: In late 1990 the IRS updated each topic that came out in early 1990 in its Exempt Organizations Continuing Professional EducationTechnical Instruction Program textbook for 1990. As a result, what you have already read

contains the topic as it was set forth in early 1990; what you are about to read is the 1990 update to that topic. We believe combining each text topic with its update will both improve and speed your research.

K. FUND-RAISING UPDATE

1. Service Publication

As a continuation of the Special Emphasis programs, the Service has recently issued additional guidance in the form of a revenue procedure, a form checksheet, and an announcement.

News Release IR-90-20 announced Rev. Proc. 90-12, I.R.B. 1990-8, 20 2/20/90. Rev. Rul. 67-246 asks charities to determine and state the fair market value of the benefits offered for contributions, in advance of a solicitation. Many charities have suggested that this determination is difficult or burdensome particularly in the case of small items or other benefits that are of token value in relation to the amount contributed. The Service has determined that a benefit may be so inconsequential or insubstantial that the full amount of a contribution is deductible under section 170 of the Code. The revenue procedure provides guidelines containing safe-harbors. In brief, the following conditions must be met to satisfy the safe-harbor.

> 1. The payment (from the donor) occurs in the context of a fund-raising campaign in which the charity informs patrons how much of their payment is a deductible contribution, and either
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> 2.(a) The fair market value of all of the benefits received in connection with payment, is not more than 2 percent of the payment, or $50, which ever is less, or
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> 2.(b) The payment is $25 or more (adjusted annually for inflation) and the only benefits received are token items containing the organization's logo. The cost of all the benefits received by a donor must, in the aggregate fall within the limits established for "low cost articles" under section 513(h)(2) of the Code. (The limits under IRC 513(h)(2) are also adjusted annually for inflation).

Form 9215 is checksheet questionnaire that was prepared for the Exempt Organizations Charitable Solicitations Compliance Improvement Program. It is being made available to charitable organizations so that they will be aware of the kind of questions they will be asked on audit. The checklist addresses the following issues, among others: fundraising; gambling; travel tours; thrift stores; goods and services received in exchange for charitable contributions; and, noncash contributions.

Announcement 90-25, 1990-8 I.R.B. 25 (2/20/90) provides information to donors and charitable organizations about the filing requirements for Form 8283, Noncash Charitable Contributions, and Form 8282, Donee Information Return. Most donors must attach Form 8283 to their income tax returns when a charitable contribution deduction is claimed that includes noncash gifts of more than $500. If a deduction of $5,000 or more is taken for an item or group of similar items a donor must have the property appraised and the appraisal summary must be signed by the donee charity. The IRS Service Centers will disallow the noncash portion, if Form 8283 is not filed. Charitable organizations that receive noncash contributions are required to file Form 8282 if they dispose of charitable contribution property within two years after the date of the contribution. There are exceptions to the filing requirement, for example, no filing is required if the property is consumed or distributed without consideration to further the purposes of the organization.

2. <u>Technical Advice Memoranda, Etc.</u>

b. <u>Technical Advice Memoranda 8832002 and 8909004</u>

Technical Advice Memorandum 9027003 should be read in conjunction with Technical Advice Memoranda 8832002 and 8909004. The activities of the organization include conducting and sponsoring conferences; publishing educational material; directing tours, and sponsoring study tours. The organization sponsored both domestic and international tours. Domestic tours were arranged by the exempt organization. For international tours, the services of a for-profit travel agency where used. There was one tour conducted with a travel agency where the organization received a payment for each participant. The payments were considered royalties by the organization. The memorandum contains a detailed analysis of a number of the organization's tours. It was concluded that most of the tours where not educational, and that the income derived from them was taxable as unrelated business income. One tour was found to be educational. As to the payments the organization considered royalties, it was concluded that the payments were not royalties because of the personal services rendered by the organization.

There was an additional issue in this case, which is germane to topic of this article. The organization indicated in its publications that a contribution was expected of persons taking the tours. It was concluded that this payment would not be considered a deductible contribution because it was not made due to the disinterested generosity of the traveler, but rather to participate in the tour. Penalties under section 6700 and 6701 were considered. In a situation where an exempt organization knowingly continued to represent that amounts paid or contributed to it would entitle an individual to a deduction when no deduction would be permitted, the provisions of either IRC 6700 or 6701 would come into play. The memorandum contains a strong warning to the organization to change its practices.

Private Letter Ruling 9004030 was issued by Chief Counsel, Income Tax & Accounting. It concerns the issue of whether contributions made to a church would be deductible when the church pays school tuition for the donor's children. The church had adopted a new policy of paying the tuition for all its members' children who attended a local school run by a church of the same denomination. The facts disclosed that the parents of the school children contributed more to the church, that their contributions where reduced when school wasn't in session, and was reduced as their children graduated. While there was no contract obligating the parents to make increased contributions, the facts led to a conclusion that the donations where made with the expectation of receiving benefits in the form of church-paid tuition for their children. Accordingly, the contributions made by the parents where not deductible as charitable contributions with the meaning of IRC 170.

3. Commensurate Test and Inurement of Income

b. Inurement of Earnings and Private Benefit

Good Friendship Temple v. Commissioner

Richard Engert V. Commissioner, TCM 1990-50, 58 TCM 1319, concerns one of the directors in Good Friendship Temple v. Commissioner. Mr. Engert paid his entire salary to a church he controlled, the Church of Modern Enlightenment. In return, the church paid all of his living expenses and there where no expenditures that could be considered church related. Charitable deductions where denied Mr. Engert in 1986, 51 TCM 1022, and the church lost its exemption in 1986. In Church of Modern Enlightenment v. Commissioner, TCM 1988-312, the Court warned Mr. Engert that he would face penalties if he continued to litigate the issue.

In this case, the Court assessed penalties under IRC 6673 for $2,500, half the maximum penalty.