

Shifting Waters: Legal and Tax Issues for Community and Health Foundations

**Community & Health Foundations Convening
Philanthropy Southwest**

February 26, 2025

Jonathan Blum and Nykolos McKissic

Holland & Knight

What is Today About?

- Nonprofit business changes
- Tax Changes
- State Action v Federal/IRS action
- Executive orders and DEI
- Tax Reform
- Lobbying and Advocacy

Corporate Transparency Act (CTA)

- In a nutshell: requires reporting to Treasury Department's Financial Crimes Enforcement Network (FinCEN) of certain "beneficial ownership interest"
- Current Status: nation-wide injunction expired
- Exemption for
 - most organizations described in Section 501(c),
 - 527 organizations,
 - Section 4947 trusts,
 - wholly owned subsidiaries of above; and
 - Entities operated exclusively to benefit one or more of the above
- What about new entities that do not have an IRS Determination Letter?

California Platform Charities Registration

- On October 7, 2021, California Governor Gavin Newsom signed into law Assembly Bill 488, establishing a new statutory framework to regulate online charitable fundraising platforms.
- A charitable fundraising platform is a person, corporation, or other legal entity that provides a website, mobile device application, or other internet-based platform to Californians, and performs, permits, or enables solicitations through its platform
- The bill also regulates platform charities, which are charitable organizations that facilitate acts of solicitation on a charitable fundraising platform
- Requirements for charitable fundraising platforms and charities
 - Registration and reporting
 - Disclosures
 - Written consent of charity beneficiaries
 - Soliciting or receiving funds only for charities in good standing
 - Segregation of funds and accounting of fees
 - Prompt distribution of donations

Artificial Intelligence

- Data privacy and protection
 - Open/closed systems
- AI Use policy – how is your staff using AI now?
- Board meeting minutes?

Inactive Organizations

- Release No 202503015
- Exemption requires compliance with BOTH
 - Organizational Test, AND
 - Operational Test
- What activities is the organization engaging in?
 - Fundraising
 - Maintaining bank accounts
 - Holding board meetings; recording of minutes
 - Filing returns/990N

Donor Advised Funds – Proposed Regulations

- Issued Nov. 2023; Public Comments Feb. 2024; Hearings May 2024
- Objective to provide definitions consistent with IRC 4966
- Some key terms defined:
 - What is a “donor advisor”
 - What is a “donor advised fund”
 - What is a “distribution”

How Might Proposed DAF Regs Impact Nonprofits

- Increased technology costs
- Increased administration costs
 - Additional staffing required to perform basic due diligence on grantees
- Dramatic slow-down in connection with grant-making
 - Cannot rely on technology; manual processes will be required
 - Direct communication with grantees to confirm lack of control

How Might Proposed DAF Regs Impact Donors

- Potential loss of ability to designate financial advisor to invest DAF
- Potential loss of ability to recommend grants to organizations in which donor or certain “related” parties serve on the board
- Likely increase in administration fees charged against DAF accounts
- Substantial increase in the cost incurred for contributing complex assets
- Certain group giving DAFs will no longer be permitted

Other Proposals Related to DAFs

- Elimination of qualifying distribution credit for private foundation grants to DAFs
 - Delayed until DAF makes subsequent grant?
- Mandatory/minimum payout requirements
- Account level disclosure
- Account level statistical reporting
- Matching of deductions with grants
- Changes in timing for deductions of complex assets

Fighting Terrorism

- Ways and Means Passed Legislation
 - HR 8290 – Foreign Grant Reporting Act
 - Require public disclosure of grants made by certain tax-exempt organizations to foreign entities
 - HR 8293 – American Donor Privacy and Foreign Funding Transparency Act
 - Require disclosure of data on contributions received by tax-exempt organizations from foreign sources
 - Neither legislative proposals went further

Fighting Terrorism

- House Passed HR 9495 – Step Terror-Financing and Tax Penalties on American Hostages Act
 - Terminate exempt status of organizations deemed to be “terrorist supporting organizations” by Treasury Secretary, extends IRC Section 501(p) authority
 - Gives Secretary authority to revoke the tax-exempt status of organizations that have provided material support to designated foreign terrorist organizations
 - Eliminates due process protections; have 90 days to prove innocence
 - “Chain” enforcement rule
 - What is “supports” terrorism?
 - Legislation went no further

Fighting Terrorism, *continued*

- Are the criticisms of these proposals reasonable?
- Canada Revenue Agency revocation of exemption of Jewish National Fund of Montreal
- Charity Commission for England and Wales Official Warning to Chabad Lubavitch Centers North East London and Essex Limited
- Questions to Consider
 - As countries lean more nationalist, are there trends to consider?
 - When a nonprofit or a private foundation engages in activities outside the US, what steps should be taken to ensure compliance?
 - Are old “best practices” sufficient?

State Action

- Paxton v FIEL
 - revoke state charter because corporation violated the prohibitions against substantial lobbying and campaign intervention
- Annunciation House
 - Revoke state charter for encouraging illegal immigration
- NRA case
- Others....

Common Audit Issues

- Employee classification – employee vs independent contractor
- Debt-financed income (UBIT)
- Sale of merchandise (UBIT)
- Form 990 inconsistencies
- Whistleblower

Executive Orders and Legislative Proposals

- DEI
- USAID
- DOGE and federal budget cuts

- Proposed elimination of Department of Education
- Increased endowment excise tax to colleges and universities (IRC Section 4968)
- Proposal to eliminate scholarship and fellowship income exclusion (IRC Section 117)

Diversity, Equity and Inclusion

- Fearless Fund settlement
- Section 1981 of Civil Rights Act of 1866 prohibits discrimination on the basis of race in making/enforcing private contracts
 - What is a contract?
 - Nature of opportunity to join – open to broad group (more likely contract) vs. careful nomination/selection/private personal relationship
 - Nature of program/compensation – quid pro quo (more likely contract) vs. observation/training/no payment/temporary/not required for employment
 - Examples: race-based scholarships
 - Exception: First Amendment
 - Associational rights – do interests of organization in transmitting values, ideals, beliefs, particular message, etc. outweigh government interest in prohibiting discrimination (i.e., preserving expressive purposes requires excluding/limiting other groups)
 - Artistic expression – performing/creative arts content (i.e., race-based casting decisions upheld for Bachelor/Bachelorette in Tennessee case)

Diversity, Equity and Inclusion, *continued*

- Considerations for structuring private contracts:
 - Broad definition of diversity/underrepresentation beyond race/ethnicity that impact life/accomplishments
 - Open to all while encouraging diverse candidates
 - Race-neutral criteria
 - Entities/programs formed to explicitly support communities of people must be aware of potential “reverse discrimination” liability
- Guidelines to consider for nonprofits with race-conscious grantmaking or other activities:
 - Focus on charitable purpose and identify a charitable class
 - Consider individuals/businesses as conduits to reach charitable class

Diversity, Equity and Inclusion, *continued*

- Other court cases
- State AG action
- Ways & Means Proposal
 - make DEI Union Expenses non-deductible; currently federal unions can deduct DEI training expenses because it is educational

Executive Orders - Background to Where We Are

- Students for Fair Admissions
- January 20 Executive Order
 - wholly eliminated all DEI programs throughout the federal government, including "Chief Diversity Officer" positions, as well as equity-related grants and contracts
- January 21 Executive Order
 - revoked previous administration's EOs that promoted DEI, affirmative action and equal opportunity programs
 - Eliminated historic DEI requirements from federal contracting
- February 5 Department of Justice Memo
 - “the Department of Justice's Civil Rights Division will investigate, eliminate, and penalize illegal DEI and DEIA preferences, mandates, policies, programs, and activities in the private sector and in educational institutions that receive federal funds
- February 22 preliminary injunction by Maryland court

What is said and what is not said

- January 21 EO
 - takes direct steps relating to federal contractors, subcontractors and grantees
 - creates an investigative framework for other actors (e.g., private companies, certain nonprofits)
- Use of the phrase: “programs promoting DEI that violate any applicable Federal anti-discrimination laws”
- What does this mean?
 - “applicable Federal discrimination laws”
 - “civil investigations”
- Department of Justice Memo
 - programs, initiatives, or policies that discriminate, exclude, or divide individuals based on race or sex

Targeting the Private / Tax-Exempt Sector

- Mandated report from the Attorney General to the White House
 - By May 1, 2025
 - AG to work “in consultation with the heads of relevant agencies”
- Contents of report
 - “Key sectors of concern” within each agency’s jurisdiction
 - Most “egregious and discriminatory” entities in each sector of concern
 - A plan of specific steps or measures to deter DEI programs that are “illegal” within the identified sectors

Targeting the Private / Tax-Exempt Sector: “A plan of specific steps or measures”

- *Each Agency:*
 - Identify *up to nine* potential **civil compliance investigations** of:
 - Publicly traded corporations
 - Large non-profit corporations or associations
 - Foundations with assets of \$500 million or more
 - State and local bar and medical associations
 - Institutions of higher education with endowments over \$1 billion
 - AG to work “in consultation with the heads of relevant agencies”
- Other strategies to “encourage” the end of illegal DEI discrimination and preferences
- Litigation for Federal lawsuits, intervention, or statements of interest

Targeting the Private / Tax-Exempt Sector: “Civil Compliance Investigations”

- *What?*
 - Not defined
 - Unclear statutory basis for initiating such investigations
- *What could this mean?*
 - DOJ Office of Civil Rights investigations
 - USA investigations with aggressive interpretations of what constitutes “illegal” DEI activity
 - Agency-initiated actions
- *Don’t ignore Congress, State AGs*
 - *EO is a signal to congressional committees, state AGs, and others to dig into this area*

What now?

- Pause –
 - Internal review
 - Risk assessment
 - Assess current DEI programs
 - Firm up allies, think of rapid response plan in the event of investigations
- No overreaction
 - Not the time to change websites, policies, make major decisions. Breathe.
- Prepare for heightened scrutiny of private sector DEI.
 - Be ready to legally defend practices

Tax Reform in 2025

- Expiring increased charitable deduction for cash gift to public charities
 - 60% limitation goes back to 50%
 - Proposal to convert charitable deduction to above the line
- Expiration of SALT limit
 - Impacts on charitable gifts
- Extension of TCJA estimated cost: \$5-6 trillion
- Getting legislation passed ----- Reconciliation Process; requires only a simple majority
- Competing Views
 - Jason Smith: one big reconciliation bill
 - John Thune: two step process with tax reform reserved for later
 - Trump: appears to be waffling

Wide Range of Proposals Impacting Charities/Giving

- Deduction limits
 - Lifetime limit
 - Annual limit (eg, \$10,000)
 - estate-tax deductions
- Replace charitable deduction with tax credit, subject to certain limitations
- Create universal tax credit for households charitably contributing more than 2% of their adjusted gross income
- Tax closely held assets of private foundations and DAFs
- Tax all assets owned by charities other than contributions
- Remove exclusion of private foundations and DAFs from qualifying for IRA contributions

Endowment Tax

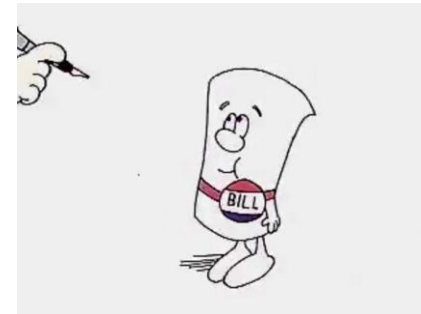
- Under TCJA (generally)
 - Colleges and Universities with:
 - more than 500 students, and
 - More than \$500,000 per student in endowment
 - Taxed 1.4% on net investment income
- Ways & Means
 - Raise tax to 14%
- HR 8913
 - Increase applicability of tax
 - Change criteria for calculating the number of students
 - Impact: increase the number of schools applicable by 10-12%
- Congressman Troy E. Nehls; Endowment Tax Fairness Act
 - Increase tax to 21%

Other Issues and Proposals

- HR 8914
 - Response to Gaza protests and related issues
 - Enact penalties for colleges and universities that violate a student's rights under Title VI
- Assignment of Income and charitable donations
- NIL Collectives; Higher Ed and Sports
- Nonprofit/For-profit JVs
- Hospitals and Charity Care

Revival of Prior Tax Reform Proposals?

- Treating any sale or licensing of name and logo as unrelated business income, not as passive income (2014 and 2017)
- Dual status entities would be subject to UBIT even if exempt under 501(c) and another Code section (such as state and local government entities, including public pension plans that are exempt under Section 115(1)). (2017)



Revival of Prior Tax Reform Proposals? (cont.)

- Modifying rules concerning qualified sponsorship payments (2014)
 - If a sponsor pays more than \$25k for any one event, use of sponsor's name or logo would be required to be proportionate to other donors or UBIT would apply
 - Use or acknowledgement of sponsor's products would be advertising
- Parity of charitable contribution limit between trusts and corporations for purposes of UBIT at 10 percent (2014)
- Repeal of exclusion from UBIT gain or loss from disposition of distressed property (512(b)(16) (2014))
- Increase in specific deduction for UBIT from \$1,000 to \$10,000 (2014)

Lobbying Activity - Overview

- Public Policy Advocacy
 - Relationship Building
 - Education
 - Influencing legislation and ballot measures
 - Influencing administrative action
 - Litigation
 - Non-501(c)(3) – Political campaign activity
- Political Campaign Activity vs. Lobbying

Lobbying Activity – Overview (continued)

- 501(c)(3) Public Charities
 - only insubstantial Lobbying Activity
 - prohibited from engaging in Political Campaign Activity
- 501(c)(3) Private Foundations
 - may not engage in Lobbying Activity or Political Campaign activity
- 501(c)(4) and 501(c)(6) organizations may engage in substantial lobbying and some political activity

Lobbying Activity- Expenditure Test

- No “Substantial Part” Test
 - More Subjective – how much is substantial? 5% ok?
 - Facts and Circumstances
 - Measure by Time and Money, includes volunteer time
- **Section 501(h) Election – Expenditure Test**
 - Objective Test
 - Based on expenditures
 - Direct Lobbying Communication and/or Activity
 - Grassroots Lobbying Communication and/or Activity
 - Report activities on Form 990, Schedule C

Lobbying Activity- Expenditure Test (cont'd)

- 501(h) Expenditure Test
 - 20% of first \$500,000 of exempt purpose expenditures
 - 15% of next \$500,000
 - 10% of next \$500,000
 - 5% of expenditures over \$1,500,000
 - Maximum \$1,000,000 (\$250,000 grassroots)
 - Separate limit on grass roots lobbying of 25% of the above limitations

What is Lobbying?

- Attempts to Influence Legislation
 - Federal, State, Local
- Attempts to Influence Public As Law Makers
 - In referendum, initiative, or constitutional amendment
- **Not** Lobbying to Influence Executive Branch or Independent Regulatory Agencies
- **Not** Lobbying if allocation of already appropriated funds
- But Lobbying is Attempting to Influence the Confirmation of a Judicial Appointment

What is “Legislation” and “Specific Legislation”

- “Legislation” includes action by the Congress, any state legislature, any local council, or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure. “Legislation” includes a proposed treaty required to be submitted by the President to the Senate for its advice and consent from the time the President's representative begins to negotiate its position with the prospective parties to the proposed treaty.
- “Specific legislation” includes both legislation that has already been introduced in a legislative body and a specific legislative proposal that the organization either supports or opposes. In the case of a referendum, ballot initiative, constitutional amendment, or other measure that is placed on the ballot by petitions signed by a required number or percentage of voters, an item becomes “specific legislation” when the petition is first circulated among voters for signature.

What is Lobbying? Expenditure Test (continued)

- ***Grassroots Lobbying***

- Influence Opinion (Education) and Call to Action about specific legislation
 - Call your Member of Congress
 - Click to send email to Member of Congress
 - Sen. Jones is your senator
 - Sen. Jones is on the committee considering the bill
 - Certain mass media ad runs close to vote, even without call to action

- ***Direct Lobbying***

- Communication with Legislator expressing a view about specific legislation

- ***Member Communications*** - Encourage recipient to engage in direct lobbying?
Grassroots?

Lobbying Activity- What is NOT Lobbying for Expenditure Test?

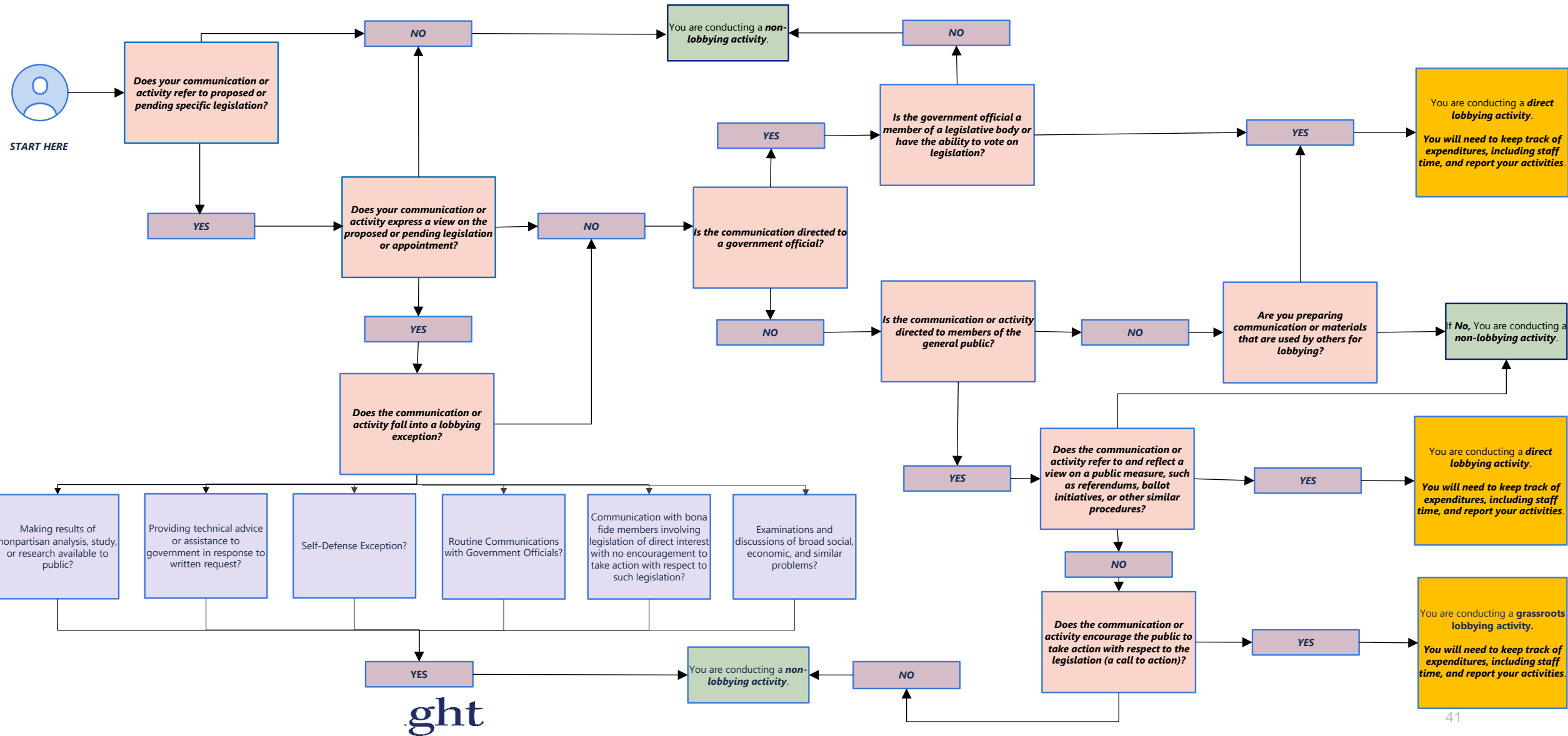
- Nonpartisan Analysis, Study or Research
- Providing technical advice or assistance to legislative body on written request by govt.
- Self-Defense Exception
 - Appearances before and communication to legislature relative to the organization's existence, status or deductible contributions
- Communications between exempt organization and its membership about legislation of direct interest but no call to action
- Routine communication with officials and employees
- Volunteer Time – Not Counted for Expenditure Test

Costs for Expenditure Test

- **All costs of preparing a direct or grass roots lobbying communication, including expenditures for researching, drafting, reviewing, copying, publishing, and mailing, are taken into account as lobbying expenditures. Lobbying expenditures include the portion of administrative, overhead, and other general expenses allocable to the direct or grass roots lobbying communications. If a particular expenditure relates to lobbying purposes as well as non-lobbying purposes, a reasonable allocation must be made between the portion of the expenditure attributable to lobbying purposes and the portion not attributable to lobbying purposes. Treas. Reg. 56.4911-3(a)(1)**

IRS Form 990 Reporting – Expenditure Test Lobbying Decision Tree*

*This graphic is illustrative purposes only and should not be taken as legal advice. It does not cover LDA reporting.



Questions?

Jonathan Blum
Partner



Holland & Knight LLP
One Arts Plaza
1722 Routh Street, Suite 1500
Dallas, Texas 75201
Phone: 214-969-1192
Email: jonathan.blum@hklaw.com

Nyk McKissic
Associate Attorney



Holland & Knight LLP
One Arts Plaza
1722 Routh Street, Suite 1500
Dallas, Texas 75201
Phone 214-969-2131
Email: nykolas.mckissic@hklaw.com