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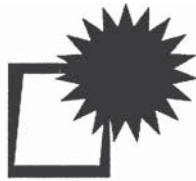
**Bruce R. Hopkins**

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# The Law of Tax-Exempt Organizations

ELEVENTH EDITION



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BRUCE R. HOPKINS

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Mr. Hopkins is the Professor of Practice at the University of Kansas School of Law. He teaches the course on nonprofit, tax-exempt organizations. Mr. Hopkins is the series editor of Wiley's Nonprofit Law, Finance, and Management Series. In addition to *The Law of Tax-Exempt Organizations, Eleventh Edition*, he is the author of the *Bruce R. Hopkins' Nonprofit Law Dictionary*; *Bruce R. Hopkins' Nonprofit Law Library* (e-book); *Tax-Exempt Organizations and Constitutional Law: Nonprofit Law as Shaped by the U.S. Supreme Court*; *Planning Guide for the Law of Tax-Exempt Organizations: Strategies and Commentaries*; *IRS Audits of Tax-Exempt Organizations: Policies, Practices, and Procedures*; *The Tax Law of Charitable Giving, Fifth Edition*; *The Tax Law of Associations*; *The Tax Law of Unrelated Business for Nonprofit Organizations*; *The Nonprofits' Guide to Internet Communications Law*; *The Law of Intermediate Sanctions: A Guide for Nonprofits*; *Starting and Managing a Nonprofit Organization: A Legal Guide, Sixth Edition*; *Nonprofit Law Made Easy*; *Charitable Giving Law Made Easy*; *Private Foundation Law Made Easy*; *Fundraising Law Made Easy*; *650 Essential Nonprofit Law Questions Answered*; *The First Legal Answer Book for Fund-Raisers*; *The Second Legal Answer Book for Fund-Raisers*; *The Legal Answer Book for Nonprofit Organizations*; and *The Second Legal Answer Book for Nonprofit Organizations*; and he is the coauthor, with Jody Blazek, of *Private Foundations: Tax Law and Compliance, Fourth Edition*; with David O. Middlebrook, of *Nonprofit Law for Religious Organizations: Essential Questions and Answers*; with Thomas K. Hyatt, of *The Law of Tax-Exempt Healthcare Organizations, Fourth Edition*; with Douglas K. Anning, Virginia C. Gross, and Thomas J. Schenkelberg, of *The New Form 990: Law, Policy, and Preparation*; with Ms. Gross, of *Nonprofit Governance: Law, Practices & Trends*; and with Alicia M. Kirkpatrick, of *The Law of Fundraising, Fifth Edition*. He also writes *Bruce R. Hopkins' Nonprofit Counsel*, a monthly newsletter, published by John Wiley & Sons.

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## ABOUT THE AUTHOR

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# Preface

A highlight of my life is writing books, published by John Wiley & Sons, about the law applicable to nonprofit organizations. I began in the early 1970s and haven't been able to stop. I am the author or coauthor of more than 30 books during these years; more wait in the wings. *The Law of Tax-Exempt Organizations*, however, remains special, inasmuch as it is the first book I wrote. I find it extraordinary that it is now in its eleventh edition.

By the time this edition is available, the book will have been in print for more than 40 years. Sometimes, I prefer not to think of the thousands of hours that underlie this and my other projects. Certainly the field of tax-exempt organizations law has been dynamic, volatile at times; the fact that this book is now in its eleventh edition is testament to the complexity of the subject matter and its astounding and steady growth. In fact, the number of books in the Wiley Nonprofit Law, Finance, and Management Series, and the wonderful range of that material, evidences the explosiveness of the nonprofit sector over recent decades.

Most of the law reflected in this book did not exist 50 years ago. Tax exemption was (constitutionally) introduced in 1913, and the unrelated business income rules arrived in 1950. A considerable portion of the statutory law of tax-exempt organizations is the product of enactment of the Tax Reform Act of 1969. (I am often asked how I found myself practicing in the realm of tax-exempt organizations. I began practicing law in 1969. I got caught up in the writing and interpreting of the law Congress passed that year, and I just kept on going.)

This body of statutory law has been significantly expanded by many major and minor tax acts. In recent years, the field has been enlarged by enactment of the American Jobs Creation Act of 2004, the Working Families Tax Relief Act of 2004, the Katrina Emergency Tax Relief Act of 2005, the Tax Increase Prevention and Reconciliation Act of 2006, the Pension Protection Act of 2006, the Tax Technical Corrections Act of 2007, the Patient Protection and Affordable Care Act, the Health Care and Education Reconciliation Act of 2010, and the Tax Increase Prevention Act of 2014.

But the federal tax law affecting exempt organizations is by no means confined to statutes. Like other areas of tax law, the field is heavily informed by Treasury Department regulations, Internal Revenue Service (IRS) revenue rulings and revenue procedures, and opinions from various federal courts. More so than in other aspects of the tax law, the world of tax-exempt organizations is dramatically affected almost daily by IRS private determinations, usually in the form of private letter rulings, technical advice memoranda, and chief counsel advice memoranda. All of this has resulted in a mammoth and expanding body of law.

The past decade or so alone bears witness to an immense augmentation of the federal tax (and other) law of tax-exempt organizations. Developments in the

## PREFACE

health care, higher education, private foundations, political organizations, and associations fields, just to name a few, have been awesome to watch and challenging to chronicle. Other notable expansions of this law have occurred and are occurring in the realms of private inurement and private benefit, legislative and political activities, the applications for recognition of exemption and the annual information returns, the use of partnerships and subsidiaries, the commerciality doctrine, and the unrelated business rules.

New bodies of law have also emerged. While perhaps the most notable are the intermediate sanctions rules, others include disclosure and document distribution requirements, exempt organizations and insurance, mergers and other reorganizations, tax shelter penalties, and fundraising regulation.

This book evolved out of materials developed for the course on tax-exempt organizations that I taught for 19 years at the George Washington University Law School, in Washington, D.C., beginning in 1973. It also reflects hundreds of questions asked by law students and seminar and conference attendees over the years. It has been shaped further by the inquiries of clients and colleagues. At the same time, the task has been to capture all of the law and developments across the entire field.

I have tried to provide a summary of the law of tax-exempt organizations, one that is sufficiently general to present the subject in all of its marvelous expanse yet with enough particularity to give the reader the specifics when needed. Thus, the book has been written in as nontechnical a way as I can muster, yet with footnotes and other sources that lead to more detailed information. The latter include references to Internal Revenue Code provisions, tax regulations, court opinions, and public and private rulings from the IRS.

It is hoped that lawyers, managers, accountants, directors and officers, fundraising executives, and students of the field can use this book to learn particular aspects of the subject matter or to refresh their minds about one rule or another. The book is designed for the newcomer as well as for the expert practitioner.

This edition is larger than the previous ones, except for the ninth. The book would be even thicker but for some tightening of the writing and jettisoning of various sections. The single most important reason for this relative shrinkage, however, is that I removed nearly 200 pages of the law concerning private foundations and incorporated it into a separate book (*Private Foundations: Tax Law and Compliance, Fourth Edition*, John Wiley & Sons, 2014, coauthored with Jody Blazek). Private foundation law is still covered in this book (see Chapter 12), but the details in this area are now in that companion volume. Further trimming occurred when four other books were published—*The Tax Law of Unrelated Business for Nonprofit Organizations* (2005); *The Tax Law of Associations* (2006); *The New Form 990: Law, Policy, and Preparation* (2009) (coauthored, respectively, with Douglas K. Anning, Virginia C. Gross, and Thomas J. Schenkelberg); and *Nonprofit Governance: Law Practices and Trends* (2009), coauthored with Ms. Gross. These topics are nonetheless reflected in this book (see Chapters 24 and 25, 14, 28, and 5, respectively).

There have been other instances of tightening of this nature. I am the author or coauthor of books on charitable giving, fundraising regulation, intermediate sanctions, Internet communications, and health law. These efforts, too, have helped to curb the size of this book. Nonetheless, there is not enough space in



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the book for a detailed analysis of cases, rulings, and the like. I try to provide such analysis, however, in my monthly newsletter, *Bruce R. Hopkins' Nonprofit Counsel*, which is now in its 32nd year. The newsletter includes references to this book for additional reading and background information. The newsletter is a stand-alone publication; at the same time, for those with the book, it also serves as a monthly update.

I observed earlier that the law of tax-exempt organizations is expansive. All indications are that more, perhaps much more, exempt organizations law is in the offing. For example, new rules for Type III supporting organizations are having deleterious effects (except for lawyers), regulations to accompany the donor-advised funds rules will eventuate, law will emanate concerning nonprofit governance (perhaps by further application of the private benefit doctrine), there may be litigation concerning charitable organizations' involvement in political campaigns, and guidance as to the additional rules for exempt hospitals is being provided.

The most recent star of this show, of course, is the revamped Form 990. Despite its size, complexity, and overreaching, this return is a work of art. For large exempt organizations, proper preparation of this return is a mighty feat. But that is not the stuff of law development, although this return preparation entails considerable lawyering. The revised Form 990 is no mere government form; the issuance of the redesigned Form 990 is akin to publication of a mammoth set of regulations. Much new "law" is embedded in this return. In the context of nonprofit law, there has never been anything like it before. Touted by its handlers as a vehicle for acquiring information and promoting transparency, the real story is the enormous impact this return is having in modifying the behavior of the leaders, managers, and representatives (including lawyers and accountants) of exempt organizations, particularly in terms of development of policies, procedures, protocols, and other forms of governance practices.

The IRS has suffered mightily over the last two years or so in the tax-exempt organizations setting. Triggered by a mishandling of a relative handful of applications for recognition of exemption, the resulting brouhaha nearly destroyed the Exempt Organizations Division. As it is, much of its top management is gone and replaced, and the authority for much of the technical work of the Tax Exempt and Government Entities (TE/GE) Division has been delegated to the Office of Chief Counsel. A number of significant initiatives were under way when the debacle began; they are all now languishing. The IRS will rebound from these disasters, but that will take considerable time.

Tax regulations, private rulings, and court opinions that are certain to come will continue to enhance and invigorate the law of tax-exempt organizations. All bodes well, despite the IRS's crisis, in this regard for nonprofit lawyers (and for the supplements and twelfth edition).

Clichés about a book like this abound. "Labor of love" and "work in progress" come to mind. The most important one of all, however, has to be said: There have been many individuals along the way who have helped enormously, doing much to nurture the book over the years, particularly my friends and colleagues at John Wiley & Sons. Most notable in the past have been Walter Maythem, Dick Lynch, Jeffrey Brown, Marla Bobowick, Martha Cooley, Robin Goldstein, and Susan McDermott. I thank my senior editor, Matthew Davis; production editor,

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Suganya Babu; and development editor, Christine Moore, for their support in the production of this edition of the book.

Revising and updating a book of this nature is a time-consuming project, requiring much intense focus. In reflection of these facts, I also extend my gratitude to my dear wife, Bonnie J. Buchele, for her patience, understanding, and support.

**Bruce R. Hopkins**

*April 2015*

# About the Online Resources

*The Law of Tax-Exempt Organizations, Eleventh Edition* is complemented by a number of online resources.

For a list of all Wiley books by Bruce R. Hopkins, please visit [www.wiley.com/go/hopkins](http://www.wiley.com/go/hopkins).

Also, please visit [www.wiley.com/go/hopkinstaxexempt](http://www.wiley.com/go/hopkinstaxexempt) to download various tables and forms in PDF format to use alongside this *Tenth Edition*. The tables include:

- Table of Cases
- Table of IRS Revenue Rulings
- Table of IRS Revenue Procedures
- Table of IRS Private Determinations Cited in Text
- Table of IRS Private Letter Rulings, Technical Advice Memoranda, and General Counsel Memoranda
- Table of Cases Discussed in *Bruce R. Hopkins' Nonprofit Counsel*
- Table of IRS Private Determinations Discussed in *Bruce R. Hopkins' Nonprofit Counsel*



# Book Citations

Throughout this book, 13 books by the author (in some instances as coauthor), all published by John Wiley & Sons, are referenced as follows:

1. *IRS Audits of Tax-Exempt Organizations: Policies, Practices, and Procedures* (2008): cited as *IRS Audits*
2. *The Law of Fundraising, Fifth Edition* (2014): cited as *Fundraising*
3. *The Law of Intermediate Sanctions: A Guide for Nonprofits* (2003): cited as *Intermediate Sanctions*
4. *The Law of Tax-Exempt Healthcare Organizations, Fourth Edition* (2014): cited as *Healthcare Organizations*
5. *The New Form 990: Law, Policy, and Preparation* (2009): cited as *New Form 990*
6. *Nonprofit Governance: Law, Practices and Trends* (2009): cited as *Nonprofit Governance*
7. *The Nonprofits' Guide to Internet Communications Law* (2003): cited as *Internet Communications*
8. *Planning Guide for the Law of Tax-Exempt Organizations: Strategies and Commentaries* (2004): cited as *Planning Guide*
9. *Private Foundations: Tax Law and Compliance, Fourth Edition* (2014): cited as *Private Foundations*
10. *Starting and Managing a Nonprofit Organization: A Legal Guide, Sixth Edition* (2013): cited as *Starting and Managing*
11. *The Tax Law of Associations* (2006): cited as *Associations*
12. *The Tax Law of Charitable Giving, Fifth Edition* (2014): cited as *Charitable Giving*
13. *The Tax Law of Unrelated Business for Nonprofit Organizations* (2005): cited as *Unrelated Business*
14. *Tax-Exempt Organizations and Constitutional Law: Nonprofit Law as Shaped by the U.S. Supreme Court* (2012): cited as *Constitutional Law*.

The second, fourth, ninth, and twelfth of these books are annually supplemented.

Updates on all of the foregoing subjects (plus *The Law of Tax-Exempt Organizations*) are available in *Bruce R. Hopkins' Nonprofit Counsel*, the author's monthly newsletter, also published by John Wiley & Sons.



# The Law of Tax-Exempt Organizations

ELEVENTH EDITION





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P A R T O N E

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# Introduction to the Law of Tax-Exempt Organizations

Chapter One

Definition of and Rationales for Tax-Exempt Organizations

Chapter Two

Overview of Nonprofit Sector and Tax-Exempt  
Organizations