
Conprofit:

*How the IRS's Failed Oversight Allows
Nonprofit Money Laundering*



CAUSE
of ACTION

Advocates for Government Accountability



Investigative Report

**Conprofit: How the IRS's Failed Oversight
Allows Nonprofit Money Laundering**

About Cause of Action

Mission

Cause of Action is a nonprofit, nonpartisan government accountability organization that fights to protect economic opportunity when federal regulations, spending, and cronyism threaten it. Our mission is to expose the ways our government is playing politics in its use of taxpayer dollars, in its decision-making on behalf of individual Americans, and how it seeks to burden the economic opportunities that employ us and make our lives better. Cause of Action seeks to prevent the federal government from politicizing agencies, rules, and spending by bringing transparency to the federal grant and rule-making processes. Cause of Action's representation of organizations and individuals helps to educate the public about government overreach, waste, and cronyism.

Investigative Function

Cause of Action uses investigative tools to attack federal government waste, fraud, and mismanagement as well as overreach in the form of arbitrary and burdensome regulations. Cause of Action employs "sunshine advocacy" tools to achieve its goals, including document and information requests, lawsuits, ethics complaints, and requests for investigation. Through its use of advocacy and investigatory tools, Cause of Action promotes transparency, integrity, and accountability in government. Cause of Action's investigations help expose the ways our government is mismanaging federal funds and educate the public on how government can be made more accountable. Rigorous oversight can prevent taxpayer dollars from being wasted on improper activities.

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I. Executive Summary

“We will continue to work tirelessly with our partners from SIPC, the FBI, and the IRS, to track down any and all proceeds of Madoff’s Ponzi scheme and return them to their rightful owners. . . . The investigation of prodigious fraud, like that of Madoff, remains one of the FBI’s top priorities. From robbers to fraudsters, the FBI will continue to bring to justice crooks who steal.”

-Preet Bhara, U.S. Attorney

“Nonetheless, there are some investigations underway. The California attorney general’s office has received sufficient complaints to have begun its own investigation. . . . [C]ontacts have been made with the FBI and the Los Angeles district attorney. . . . Meanwhile, these projects will have to track down known donors, explain the details of what amounts to a fiscal sponsorship Ponzi scheme, and hope that the donors will be willing to ante up more money to make up what was lost.”

-Nonprofit Quarterly

The two above quotes may sound like depictions of the same problem, but the first statement was made by U.S. Attorney Preet Bharara concerning the money laundering, embezzlement, and fraud of white collar criminal Bernie Madoff. The second, however, came from a *Nonprofit Quarterly* [article](#) about the nonprofit International Humanities Center that defrauded over 200 projects it sponsored and ran off with nearly \$1 million.

While the IRS’s recent attention has been focused on scrutinizing tax-exempt applications, it has approved the tax-exempt status of charities that have engaged in money laundering and fraud. This system of abuse involves CEOs and corporate fraud, but its culprit cannot be found on Wall Street or in the boardrooms of large, publicly-traded corporations. This fraud occurs in small, tax-exempt nonprofits, often run by one or two individuals who have discovered an opening in the tax code that allows them to dupe unsuspecting start-up charities and fly under the radar of an over-complicated tax code.

What follows in this report, based on Cause of Action’s fifteen-month investigation, is an account of a dangerous pattern of abuse that has destroyed jobs and ruined charities whose aim was the public good. This abuse, combined with fabricated tax documents and bank statements and the mismanagement of federal grant money, paints a picture of corruption protected under the auspices of a process called fiscal sponsorship that is unmanaged, unchecked, and undefined by the Internal Revenue Service (IRS).

Whether through Congress or IRS rulemaking, the abuse of fiscal sponsorship warrants correction to protect taxpayers and charities. By clearly defining the parameters and standards of fiscal sponsorship, the IRS can alleviate its backlog of failed oversight of tax-exempt groups and prevent future nonprofit Ponzi schemes.

Fiscal sponsorship was intended for good, but is being used for harm

When individuals seek to establish a new charity, they often apply for 501(c)(3) tax-exempt status in order to receive tax-exempt donations. However, many projects only intend to exist temporarily and therefore have no incentive to seek formal tax-exempt status. Other projects may require donations while their tax-exempt applications are being processed. Fiscal sponsorship solves these problems by allowing existing tax-exempt organizations to accept grants and donations on behalf of the charity, or “project.” As reflected by the current IRS scandal, the process for attaining tax-exempt status can be lengthy and arduous. For groups that either cannot afford the time or money to attain their own status before wanting to conduct their charitable activities, or have no desire to become an independent organization, fiscal sponsorship allows them to come under the umbrella of an existing nonprofit organization.

But despite the benefits of fiscal sponsorship, we see in the cases of International Humanities Center (IHC), Christian Community, Inc. (CCI), and Help Is Here, Inc. (HIH) that these organizations were able to use the practice of fiscal sponsorship to abuse their tax exempt status, and in some cases even commit fraud.

IHC served as a fiscal sponsor for over 200 projects, funneling almost \$1 million in project funding toward its own mismanaged debts before closing its doors.

Though IHC’s overall structure was not necessarily illegal, the organization may not have abided by the law governing sponsored projects’ individual transactions, and while the IRS was conducting an audit at the time of its collapse in 2011, former IHC employees reported to Cause of Action that the agency had focused on smaller issues and missed the fundamental problem which plagued IHC: uncontrolled and unaccountable spending.

IHC came under federal investigation for the potential mismanagement of federal grant money.

Through a Department of Energy program under the American Recovery and Reinvestment Act of 2009, Cause of Action found that IHC potentially improperly accepted federal grant funds intended for one of its sponsored projects, ultimately resulting in a DOE investigation. A criminal and civil case was pending against IHC as of April 2012 and DOE was considering debaring high-level IHC officials.

CCI fabricated tax documents, audits, and bank statements, costing its projects over \$400,000 in lost funding.

CCI’s director, Steven Clapp, ran the fiscal sponsor organization for twenty years with little repercussion for his fraudulent activities. For instance, Clapp told projects that he withheld Social Security taxes but never actually submitted the withholdings. He also failed to file accurate 990 forms with the IRS. When a former employee of one of CCI’s projects attempted to verify forms, payments, and legal filings by CCI, she discovered “nothing but fake colored pieces of paper.” Prior to joining CCI, Clapp himself spent over four years in prison for bank fraud in Illinois for forging financial statements in order to obtain loans to support his business.

Despite a history of financial fraud, the IRS was only alerted to potential problems at CCI when the organization failed to file its tax forms.

HIH preyed upon projects, improperly seizing funds, refusing to disburse funding to projects, and attempting to wrest control over projects which attempted to leave.

Under the leadership of Maggie Lane-Baker, HIH mismanaged funds intended for its projects which, without oversight by the IRS, were forced to take HIH to court. HIH not only attempted to seize donations, but also claimed control over the charitable projects themselves. When one project attempted to end its agreement with HIH, the request was denied. While Lane-Baker eventually acknowledged that she confiscated \$50,000 in funding, she claimed HIH was justified in keeping the funds. This organization not only mismanaged money, but caused its sponsored projects to expend the time and resources required to initiate litigation, all of which could have been avoided with IRS oversight and a better understanding of how to properly structure a fiscal sponsorship arrangement.

Remedy

Cause of Action's findings demonstrate a substantial lack of guidance regarding fiscal sponsorship that has subjected hundreds of charities to abuse and allowed substantial sums of donations—including federal government grants—to be mismanaged by unaccountable sponsors.

Furthermore, the IRS's failure to properly oversee tax-exempt groups puts all projects who find themselves under a non-compliant fiscal sponsor at risk of losing funding and shutting down. Either Congress or the IRS must define fiscal sponsorship and remove ambiguities that have allowed groups such as IHC, CCI, and HIH to exploit and defraud American taxpayers through fiscal sponsorship.

II. Findings

- **Finding:** While fiscal sponsorships are a useful tool for fledgling nonprofit organizations, lack of oversight leaves them highly susceptible to misuse and fraud.
- **Finding:** The International Humanities Center (IHC) abused its discretion as a fiscal sponsor, making poor business decisions and improperly using its projects' funds as a means to pay off debts. This resulted in it losing almost \$1 million in project funding.
- **Finding:** While the Department of Energy (DOE) opened an investigation upon learning from Cause of Action that the Ballona Institute received money directly from the Los Angeles Department of Water and Power (LADWP), the status of that investigation is unknown. According to information Cause of Action received, a criminal and civil case was pending against IHC as of April 2012 and DOE was considering debarring high-level IHC officials. Despite DOE's apparent enforcement action against IHC, it is nevertheless true that DOE's failure to oversee grant funds allowed IHC to commit fraud against projects. For instance, in response to a Freedom of Information Act (FOIA) request from Cause of Action, DOE stated that it had no records or applications relating to the LADWP subgrant. The FOIA officer instead stated that DOE does not follow grant money once it is given to the direct awardee. Had DOE been aware of the subgrant to Ballona, it might have realized that IHC was in serious financial trouble and was not qualified to receive a grant on behalf of Ballona. DOE's failure to oversee its grant process therefore enabled IHC to mismanage federal grant funds.
- **Finding:** Help Is Here, Inc. (HIH) abused its control as a fiscal sponsor by "preying upon" projects, improperly seizing funds for projects, refusing to disburse funding to projects, and attempting to wrest control over projects which attempted to leave.
- **Finding:** Christian Community, Inc. (CCI) abused both projects and taxpayers by fraudulently posing as a "fiscal sponsor" for twenty years. Tax documents, audits, and bank statements were fabricated and over \$400,000 in project funding was lost.
- **Finding:** The Association of Community Organizations for Reform Now (ACORN) and rebranded ACORN organizations and affiliates used fiscal sponsors as conduits to receive tax-exempt funds for partisan activities.
- **Finding:** Fiscal sponsorship has grown into its own industry in which large-scale fiscal sponsors act as business operations rather than charitable institutions.

- **Finding:** IHC and the American Institute for Social Justice (AISJ), a fiscal sponsor of ACORN, potentially abused taxpayer funding. IHC may have mismanaged a federal grant intended for its project, the Ballona Institute, while AISJ’s fiscal sponsorship of ACORN brings grants it received from the Department of Justice under question.
- **Finding:** Fiscal sponsorship lacks a formal definition. Congress must define fiscal sponsorship, much like it defined donor-advised funds in the Pension Protection Act of 2006 (PPA), in order to enable sponsors and projects to better comply with the law. If the abuse of fiscal sponsorships is not addressed, groups such as ACORN will continue to manipulate the tax code and charitable projects such as those of IHC, HIH, and CCI will continue to be at risk for exploitation and fraud.
- **Finding:** The IRS should require fiscal sponsors to file all sponsorship agreements along with their Form 990s. The IRS should also limit fiscal sponsorships by time and gross receipts in order to decrease the risk of abuse. Finally, the IRS should terminate any fiscal sponsorship arrangement if the facts and circumstances reveal indicia, whether financial or otherwise, of independence from the sponsor sufficient to warrant separate corporate status.

III. What Is Fiscal Sponsorship?

The Internal Revenue Code (IRC), pursuant to 26 U.S.C. § 501(c)(3), grants nonprofit, tax-exempt status to applicant organizations whose mission serves a public good.¹ The definition of “public good” includes organizations which are “operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster . . . amateur sports competition . . . or for the prevention of cruelty to children and animals.”² In addition, organizations that have been granted § 501(c)(3) status may receive tax-deductible grants and contributions on behalf of an organization or individual without a tax exemption.³ In this case, the nonprofit organization serves as the fiscal sponsor of the non-501(c)(3) organization, referred to as the “project.” According to Gregory Colvin, a leading tax-exempt organizations attorney and Counsel for the former California ACORN branch,⁴ these arrangements “typically arise when a person or group (a project) wants to get support from a private foundation or a government agency, or tax-deductible donations from individual or corporate donors,” and “[b]y law or preference, the funding source will only make payments to organizations with 501(c)(3)

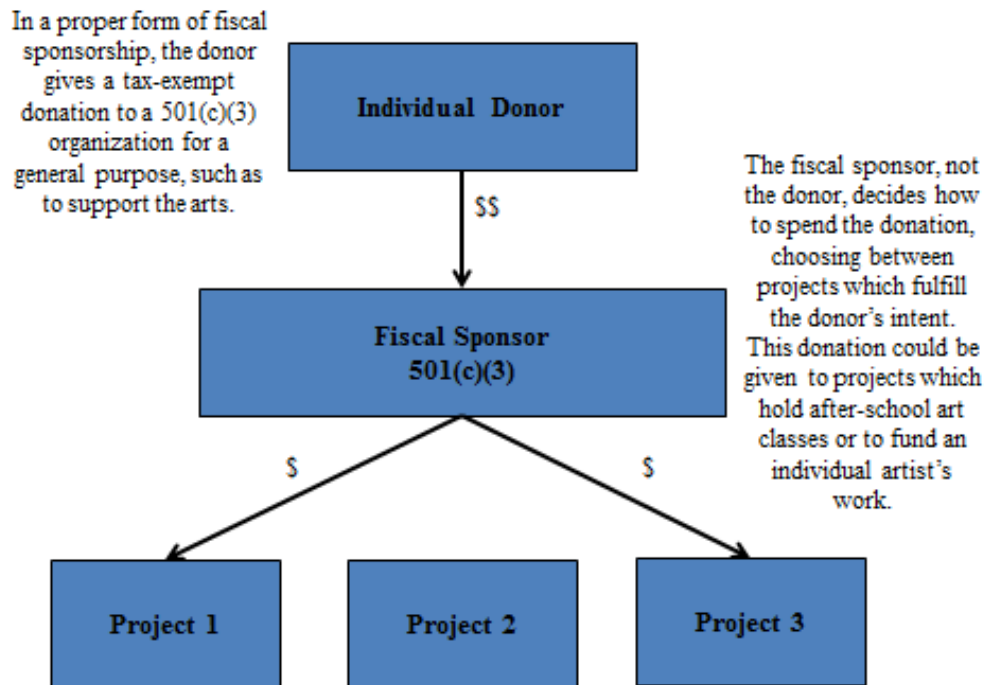
¹ 26 U.S.C. § 501(c)(3) (2012).

² *Id.*

³ GREGORY L. COLVIN, FISCAL SPONSORSHIP: 6 WAYS TO DO IT RIGHT 3 (1993).

⁴ See *Statement for the Record, Hearing on Operations and Oversight of Tax-Exempt Organizations Before the H. Comm. on Ways and Means*, 112 CONG. (2012) (statement of Mary Beth Hutchins, Commc’ns Dir, Cause of Action), available at http://waysandmeans.house.gov/uploadedfiles/cause_of_action_051612os.pdf. Colvin’s work on nonprofits and fiscal sponsorship has earned him a spot as the Co-Chair of the Subcommittee on Political and Lobbying Organization and Activities of the Exempt Organizations Committee of the Tax Section of the American Bar Association for almost twenty years. See ALDER & COLVIN, <http://adlercolvin.com/attorneys/gregory-colvin.php> (last visited June 10, 2013).

tax status.”⁵ Because it can be difficult and time-consuming to set up a new nonprofit organization and obtain tax-exempt status, “the effort is made to essentially put the group or the individual under an existing 501(c)(3) public charity and receive the benefits of foundation gifts, donations, government grants, and so on that are only available to 501(c)(3) organizations.”⁶



Unfortunately, confusion has developed over how these arrangements should be properly classified.⁷ In large part, this confusion stems from the Internal Revenue Service’s (IRS) failure to formally define these relationships.⁸ As a result, nonprofit experts have not always agreed on what to call them. In its early stages, the practice was commonly described as “fiscal agency.”⁹ However, for Colvin, the term “fiscal agency” does not reflect the proper use of these arrangements:

The arrangement should not be called “fiscal agency,” because the charity is not, and should not be, the legal agent of the nonexempt project. Under the law of agency, an agent acts on behalf of another (the principal) who has the right to direct and control the activities of the agent. If the charity is a “fiscal agent,” it implies that the project controls the charity. To comply with tax-exempt law, the relationship must be the reverse; the charity must be in the controlling position,

⁵ *Id.*

⁶ Greg Colvin, 30 EXEMPT ORG. TAX REV. 283 (December 2000).

⁷ *Id.*

⁸ See George Johnson & David Jones, *Community Foundations*, 94 TNT 71-46 (1993).

⁹ COLVIN, *supra* note 3, at 2.

and the nonexempt project must act so as to further the charity's exempt purposes.¹⁰

Colvin notes that the term "fiscal sponsorship" more accurately depicts these relationships, because it implies that the 501(c)(3) organization accepting the grants on behalf of the non-501(c)(3) organization has control over how the money is spent.¹¹ Accordingly, most experts in the nonprofit field have generally accepted the term "fiscal sponsorship" as the proper term for describing these arrangements.

A fiscal sponsorship relationship can be effectively and lawfully utilized in a variety of situations where a person or group intending to engage in charitable activities wishes to attract tax-deductible contributions without being recognized as tax-exempt by the IRS under § 501(c)(3), which can be a lengthy process.¹² For instance, a newly formed nonprofit corporation that is in the process of applying for tax-exempt status may want to receive tax-deductible contributions while its application is still pending.¹³ In such a situation, an existing 501(c)(3) "fiscal sponsor" would be enlisted to accept grants and donations on behalf of the project, which are then disbursed to the project in "the form of payments to employees, vendors, contractors, or grantees."¹⁴ Unfortunately, fiscal sponsorship arrangements can and have been exploited by both parties involved. Ineligible organizations may seek to attract tax-deductible donations they do not deserve; sponsors may seek to attract projects for the sole purpose of improperly seizing the donations they accept on the project's behalf.

IV. The Proper Use of Fiscal Sponsorships

Although fiscal sponsorship is legal and can be a very valuable tool for nonprofit organizations and their projects, it can be precarious if not managed properly. Sandy Deja, a former IRS auditor with over thirty years of experience as a tax consultant, noted, "[w]hile not necessarily illegal, these kinds of arrangements can be risky, precisely because they are carried on within a gray area of the law where IRS guidance is quite limited."¹⁵ The risk associated with the practice has led to substantial losses: in 2012 alone, three large-scale fiscal sponsors shut down at the expense of their charitable projects. The International Humanities Center (IHC) cost its projects an estimated \$1 million;¹⁶ Christian Community, Inc. (CCI) defrauded its two main projects of approximately \$600,000;¹⁷ and Help Is Here, Inc. (HIH), among many faults, has been accused of wrongly confiscating \$300,000 from its fiscally sponsored projects.¹⁸

¹⁰ *Id.*

¹¹ *Id.*

¹² TAX ECON. CHAR. GIVING § 3.02.

¹³ See Sandy Deja, *Fiscal Sponsorship*, 501CFREEBOOK, http://501cfreebook.com/Fiscal_Sponsor.html (last visited June 12, 2013).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Rick Cohen, *A Global Nonprofit Ponzi Scheme? Lessons Learned from a Fiscal Sponsor's Collapse*, NONPROFIT QUARTERLY (Feb. 14, 2012), <http://www.nonprofitquarterly.org/management/19812-a-global-nonprofit-ponzi-scheme-lessons-learned-from-a-fiscal-sponsors-collapse.html>.

¹⁷ Dan Stockman, *Question: Where's Our Cash?*, J. GAZETTE (Mar. 18, 2012) <http://www.journalgazette.net/article/20120318/LOCAL10/303189945>.

¹⁸ Geoff Link, *Arizona Fiscal Sponsor Accused of Taking \$300,000*, FISCAL SPONSOR DIRECTORY (July 23, 2012), <http://www.fiscalsponsordirectory.org/news.php>.

Gregory Colvin has observed that there is “virtually no law on the subject of fiscal sponsorship.”¹⁹ The IRS has been admittedly reluctant to concretely define and regulate “fiscal sponsorships.”²⁰ The IRS has only sparsely referred to such relationships by any sort of name and, when it does discuss such arrangements, statements on the appropriateness of fiscal sponsorship are ambiguous.²¹ For instance, in its Exempt Organizations Continuing Professional Education Technical Instruction Program textbook, the IRS states that fiscal sponsorship “occurs when one or more charities choose to financially support another charity or nonexempt project” but does not extensively detail what manner of financial support is appropriate.²² The IRS’s further statement that “[t]here is nothing inherently wrong with fiscal sponsorship” is indicative of reservations regarding fiscal sponsorship’s practical application.²³ Due to the IRS’s failure to date to concretely classify and directly regulate these arrangements, there is some degree of confusion about how fiscal sponsorships can be properly conducted.

Although the IRS has not promulgated specific regulations pertaining to “fiscal sponsorships,” its existing regulatory guidelines are quite clear in prohibiting the funneling of money in a “conduit” arrangement.²⁴ Improper conduit arrangements often arise where grants or contributions are “earmarked” for separate secondary organizations. Conduit situations always involve three players: a donor, an intermediary grantee through which earmarked contributions pass, and the actual recipient.²⁵

Abuse is likely to occur whenever a 501(c)(3) organization is used as a conduit for transactions between donors and the fiscal client. To establish whether an organization is acting as a conduit, the first inquiry is “whether money that passes through an intermediary entity was earmarked by the original contributor for a particular recipient.”²⁶ The second inquiry is to determine whether the intermediary organization should be given legal significance as an independent person or whether it should be ignored in the interest of basing legal consequences on substance and not form.²⁷ An organization serves as a conduit, even if it would otherwise be treated as an independent organization that controls its daily operations, if it simply transfers funds in a particular transaction unrelated to its ordinary business activities.²⁸

¹⁹ Colvin, *supra* note 6.

²⁰ Interview with Thomas J. Miller, Technical Advisor, Exempt Orgs. Ruling & Agreements, Tax Exempt & Gov’t Entities Div., Internal Revenue Serv. & Joseph J. Urban, Technical Advisor, Tax Exempt & Gov’t Entities Div., Internal Revenue Serv. (Mar. 10, 2010).

²¹ *Id.*

²² Johnson, *supra* note 8.

²³ *Id.*

²⁴ Rev. Rul. 68-484, 1968-2 C.B. 105.

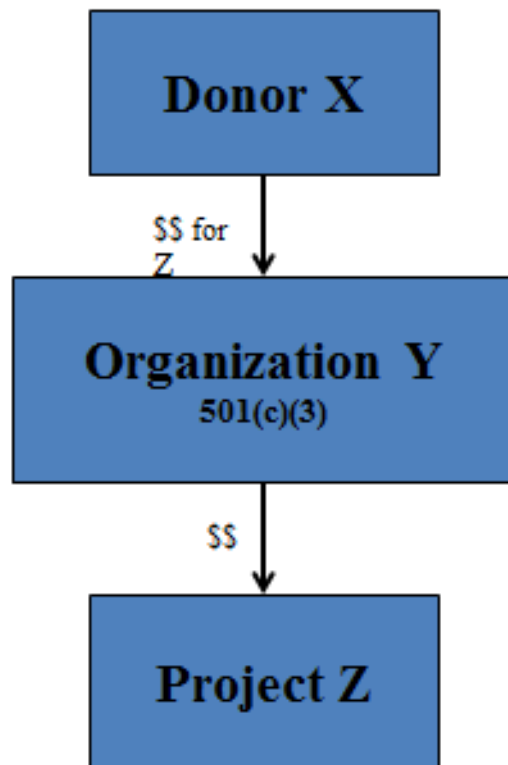
²⁵ *Id.*

²⁶ See Rev. Rul. 62-113, 1962-2 C.B. 10; Frances R. Hill, *Corporate Philanthropy and Campaign Finance: Exempt Organizations as Corporate-Candidate Conduits*, 41 N.Y.L. SCH. L. REV. 881, 920 (1997).

²⁷ *Id.*

²⁸ See *Estate of Kluener v. Comm’n*, 72 T.C.M. 1326 (1996); *Bank of America v. Comm’n*, 15 T.C. 544 (1950), *aff’d per curiam* 193 F. 2d 178 (9th Cir. 1951).

A conduit situation arises when the donor earmarks his donation for a particular project and the organization receiving the funds does not use its discretion or control to determine where the funding should go.



This donation is effectively a donation from Donor X to Project Z and is not tax-exempt.

IRS rules regulating conduit arrangements are quite strict. According to Colvin, “[w]hen a donation is made by X to Y, earmarked for Z, it is in reality a donation from X to Z. But if Z is not exempt under Section 501(c)(3), the gift is not a tax-deductible contribution.”²⁹ If the IRS discovers the existence of a “conduit” it may apply what is known as the “step transaction” doctrine, and collapse the various steps in a transaction to look at the overall result in order to determine the tax consequences. In the case of a conduit transaction, “the IRS will disregard the role of the sponsor and declare that the funding source has, in effect, made a payment directly to a non-501(c)(3) project.”³⁰ As a result, the funding source will not be able to claim a tax deduction, the project’s funding will likely vanish, and the exempt organization serving as the “conduit” may lose its tax-exempt status.³¹

The case of *S.E. Thomason v. Commissioner* is instructive on the federal government’s policy concerning conduit organizations.³² In this case and subsequent Revenue Ruling 63-252, the IRS examined contributions to a domestic charity which thereafter transmitted some or all of

²⁹ GREGORY L. COLVIN, PRESENTATION ON FISCAL SPONSORSHIP, WESTERN CONFERENCE ON TAX EXEMPT ORGANIZATIONS 2 (Nov. 17, 2006), available at http://www.fiscalsponsorship.com/images/WCTEO_Gregory-Colvin.pdf.

³⁰ COLVIN, *supra* note 3, at 28; see also *S.E. Thomason v. Comm’n*, 2 T.C. 441 (1943); Rev. Rul. 63-252, 1963-2 C.B. 101; Rev. Rul. 66-79, 1966-1 C.B. 48.

³¹ COLVIN, *supra* note 3, at 28.

³² *S.E. Thomason*, 2 T.C. 441.

its funds to a foreign organization.³³ The IRS stated it would look beyond the fact that the intermediary grantee is a charitable domestic organization and deny charitable contribution deductions if the domestic organization is only a nominal donee while the real donee is the foreign organization.³⁴

The federal government has established a long line of regulatory and legal precedents that provide the premise for conduit transactions of exempt organizations. First of all, the Supreme Court held in *Better Business Bureau of Washington, D.C., Inc. v. United States* that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.³⁵ The standard set in *Better Business Bureau* does not change even though the sponsored project, rather than the sponsoring 501(c)(3) organization, is carrying out the non-exempt activity.

If any funds given to a 501(c)(3) organization are not used for purposes consistent with its own tax-exempt purposes, it risks jeopardizing its own 501(c)(3) tax-exempt status. According to Beth Kingsley, a partner at Harmon, Curran, Spielberg & Eisenberg and also the former General Counsel of ACORN, “[a] 501(c)(3) organization’s most important legal obligation is to ensure that its funds are spent in furtherance of its charitable purposes. Failure to do so can result in excise taxes, fines, revocation of exempt status, and, in extreme circumstances, denial of tax deductions for donors or criminal prosecution for tax fraud.”³⁶

The IRS has also clearly indicated that for a 501(c)(3) organization to ensure that its funds are being used to further its own tax-exempt purpose, the 501(c)(3) must retain “discretion and control” over how the funds are used. The IRS has ruled on many cases where a 501(c)(3) has accepted funds on behalf of a non-501(c)(3) or individual. According to IRS Revenue Ruling 66-79, the primary determinant of the lawfulness of the arrangement is “whether the organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes.”³⁷

The IRS does allow 501(c)(3) organizations to accept tax-deductible donations on behalf of non-501(c)(3) organizations and individuals if certain conditions are satisfied. According to IRS Revenue Ruling 68-489, the most concrete statement of IRS policy on fiscal sponsorship

³³ Rev. Rul. 63-252, 1963-2 C.B. 101.

³⁴ Contributions to non-U.S. organizations generally are not deductible as charitable contributions for federal income tax purposes. *Id.*

³⁵ 326 U.S. 279 (1945) (holding that the taxpayer’s organization was ineligible to receive an exemption because the organization, while serving some social welfare purpose, was also organized for profit).

³⁶ *Id.*

³⁷ Rev. Rul. 66-79, 1966-1 C.B. 48; *Minn. Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938); *see also* Rev. Rul. 62-113, 1962-2 C.B. 10; Rev. Rul. 68-489, 1968-2 C.B. 210. Under FASB Statement 166, Interpretation No. 42, if money is to be treated as the sponsor’s own asset for accounting purposes, it must be established between the donor and the sponsor that the sponsor has discretion and control to unilaterally redirect the funds to another project regardless of the intent of the donor or the project. The earmarking of funds versus control of an organization’s operations “suggest[s] a typology of organizations ranging from independent organizations to pure conduits. An independent organization defines its own purposes and activities and controls the use of any money it receives. A pure conduit has no purposes of its own and exercises no control over any money it receives.” Frances R. Hill, *Corporate Philanthropy and Campaign Finance: Exempt Organizations as Corporate-Candidate Conduits*, 41 N.Y.L. SCH. L. REV. 881, 921 (1997).

arrangements, a 501(c)(3) organization is allowed to accept tax-deductible funds on behalf of a non-501(c)(3) entity if the following three conditions are satisfied:³⁸

- The project being carried out by the non-501(c)(3) organization is “in furtherance of [the 501(c)(3)’s] own exempt purposes.”
- The 501(c)(3) organization “retains control and discretion as to the use of the funds.”
- The 501(c)(3) organization “maintains records establishing that the funds were used for section 501(c)(3) purposes.”

Contributions to a 501(c)(3) which are solicited for a specific project are only deductible under 26 U.S.C § 170 of the IRC in cases where the 501(c)(3) has reviewed and approved the project as being in furtherance of its own tax-exempt purposes.³⁹

The IRS has also provided guidance on what constitutes appropriate 501(c)(3) “discretion and control” over funds it receives and remits to non-exempt organizations. In Revenue Ruling 66-79, an organization was found to be exercising full discretion and control over its funds by adhering to the following guidelines stated in its bylaws governing grants made to other organizations:

- (1) The making of grants and contributions and otherwise rendering financial assistance for the purposes expressed in the charter of the organization shall be within the exclusive power of the board of directors;
- (2) in furtherance of the organization's purposes, the board of directors shall have power to make grants to any organization organized and operated exclusively for charitable, scientific or educational purposes within the meaning of section 501(c)(3) of the Code;
- (3) the board of directors shall review all requests for funds from other organizations, shall require that such requests specify the use to which the funds will be put, and if the board of directors approves the request, shall authorize payment of such funds to the approved grantee;
- (4) the board of directors shall require that the grantees furnish a periodic accounting to show that the funds were expended for the purposes which were approved by the board of directors; and
- (5) the board of directors may, in its absolute discretion, refuse to make any grants or contributions or otherwise render financial assistance to or for any or all the purposes for which funds are requested.⁴⁰

³⁸ Rev. Rul. 68-489, 1968-2 C.B. 210; *see also* Rev. Rul. 67-149, 1967-1 C.B. 133 (“An organization was formed for the purpose of providing financial assistance to several different types of organizations which are exempt from Federal income tax . . . It carries on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations at periodic intervals.”).

³⁹ Rev. Rul. 66-79, 1966-1 C.B. 48.

A. Examples of Proper Uses of Fiscal Sponsorships

According to the IRS, “[t]here is nothing inherently wrong with fiscal sponsorship; it is what nonoperating public and private charities do.”⁴¹ Fiscal sponsorships can be used for many legitimate purposes. In fact, as Sandy Deja notes, “many small or newly formed nonprofit organizations could not exist without sponsorship of this kind.”⁴² The following are several examples of legitimate ways that fiscal sponsorships can be utilized.

1. Temporary Sponsorship of Newly-Formed Organizations without 501(c)(3) Tax-Exempt Status

Fiscal sponsorship has generally been accepted as a proper tool for nonprofits to use when it is utilized to incubate fledgling organizations that have not been formally recognized by the IRS as tax-exempt organizations. For instance, consider the case of an organization that has recently been formed for the purpose of collecting donations to find a cure to a disease that has only recently been discovered. In such a situation, the organization intends to exist for as long as it takes to find a cure for a disease and is in the process of applying for tax-exempt status under the IRS. Unfortunately, as MAP for Nonprofits, an organization serving the nonprofit community, describes, “[i]t normally takes four to six months from the time an application for tax exemption is filed with the IRS to receive notice that tax-exempt status has been granted, and that is IF the IRS has no questions about information contained in the application.”⁴³ A fledgling organization may not be able to afford to wait that long to collect tax-deductible donations, as the public’s willingness to donate to the cause may wane as media attention to the issue subsides.

As a result, according to MAP for Nonprofits, “groups in a hurry to begin operations and accept tax-deductible donations can become sponsored by an organization that already has 501(c)(3) status. By doing so, the group can apply for and accept grants, accept tax-deductible donations, and carry on other activities under the tax-exempt status of their sponsor.”⁴⁴ The National Network of Fiscal Sponsors, which establishes best practices for fiscal sponsorship, further notes that in these cases, fiscal sponsorship arrangements can allow “new community ventures to more quickly and efficiently get up and off the ground, without the delay or bureaucratic red-tape associated with incorporating and filing federal and state applications for tax exemptions.”⁴⁵

Fiscal sponsorships may also be useful in helping to incubate an organization that either has no intention of gaining tax-exempt status or wants to “test the waters” on how effective it will be as a nonprofit organization. According to Gene Takagi, an attorney who advises

⁴⁰ *Id.*

⁴¹ Johnson, *supra* note 8.

⁴² SANDY DEJA, PREPARE YOUR OWN 501(C)(3) APPLICATION: HOW TO MAKE THE IRS LOVE YOUR FORM 1023, at 120-121 (2004).

⁴³ *Fiscal Sponsorship*, MAPS FOR NONPROFITS, http://www.mapfor nonprofits.org/vertical/sites/%7B876C4FB8-E997-480F-BF5B-AFAA0F113D9D%7D/uploads/Fiscal_Sponsorship_July_2011.pdf (last visited May 24, 2013).

⁴⁴ *Id.*

⁴⁵ *Guidelines for Comprehensive Fiscal Sponsorship*, NAT’L NETWORK OF FISCAL SPONSORS, http://www.tidescenter.org/fileadmin/tc_pdfs/n nfs/NNFS-Guidelines-for-Comprehensive-Fiscal-Sponsorship.pdf (last visited May 8, 2013).

nonprofits, “[f]iscal sponsorships may be a very attractive alternative to formation of an independent tax-exempt entity where the immediate viability of a separate entity is questionable or the charitable endeavor is relatively short-term. Often, projects ‘test the waters’ through fiscal sponsorships before they determine whether to become independent tax-exempt entities.”⁴⁶

For instance, consider an organization that has been formed to collect donations to assist in relief for victims of a recent hurricane. In this situation, the organization will likely cease to be useful once the damage caused by the hurricane has been cleaned up. Individuals wishing to create a short-term organization have no incentive to apply for 501(c)(3) status, particularly because the average cost of establishing a charity is approximately \$5,000.⁴⁷ Furthermore, as Gregory Colvin describes, “[i]t’s not so easy for a new or a small organization to obtain recognition of its charitable exempt status from the IRS. While the IRS does approve most applications, the process is lengthy and costly, a nightmare for laypeople.”⁴⁸ On the other hand, fiscal sponsors usually only charge administrative fees for receiving tax-deductible donations, and these fees are often far less expensive than the cost of forming an independent organization.⁴⁹

2. Temporary Sponsorship of Individuals

According to the Foundation Center, “fewer than one out of ten foundations and very few government agencies are willing to consider proposals from individuals without institutional affiliation.”⁵⁰ The reluctance of foundations and government agencies to give directly to individuals stems in large part from the administrative costs of doing so. As the Foundation Center describes, “it takes as much administrative time and work to award a \$5,000 grant to one individual as a \$500,000 grant to a university.”⁵¹ Furthermore, funders prefer to give money to fiscal sponsors instead of directly to individuals, because “sponsors serve as a kind of buffer to dilute the funder’s responsibility in case something goes wrong.”⁵² As such, many individuals seeking to provide some type of benefit for society (academic researchers, artists, etc.) must have a fiscal sponsor accept grants on their behalf in order to receive the funds necessary to conduct this research. For example, a university may fiscally sponsor a student or professor requesting funding for a summer research or teaching project; the New York Foundation for the Arts

⁴⁶ Gene Takagi, *Fiscal Sponsorship Basics*, NONPROFITLAWBLOG.COM, http://www.nonprofitlawblog.com/home/2006/12/fiscal_sponsors.html (last visited May 8, 2013).

⁴⁷ STAN HUTTON & FRANCES PHILLIPS, *NONPROFIT KIT FOR DUMMIES* 30 (2010); JACK B. SIEGEL, *A DESKTOP GUIDE FOR NONPROFIT DIRECTORS, OFFICERS, AND ADVISORS* (2010).

⁴⁸ Gregory Colvin, 8 Exempt Org. Tax Rev. 648.

⁴⁹ GREGORY L. COLVIN, *COMPARISON OF STARTING A NEW 501(C)(3) ORGANIZATION WITH USING A FISCAL SPONSOR (MODEL A)* (2008), *available at*: http://www.fiscalsponsorship.com/Compare%20501c3%20w%20Fisc%20Spon%20Model%20A%20_00075865-2_.pdf.

⁵⁰ *Guide to Fiscal Sponsorship*, FOUND. CENTER, http://foundationcenter.org/getstarted/tutorials/fiscal/inst_aff.html (last visited May 8, 2013).

⁵¹ *Id.*

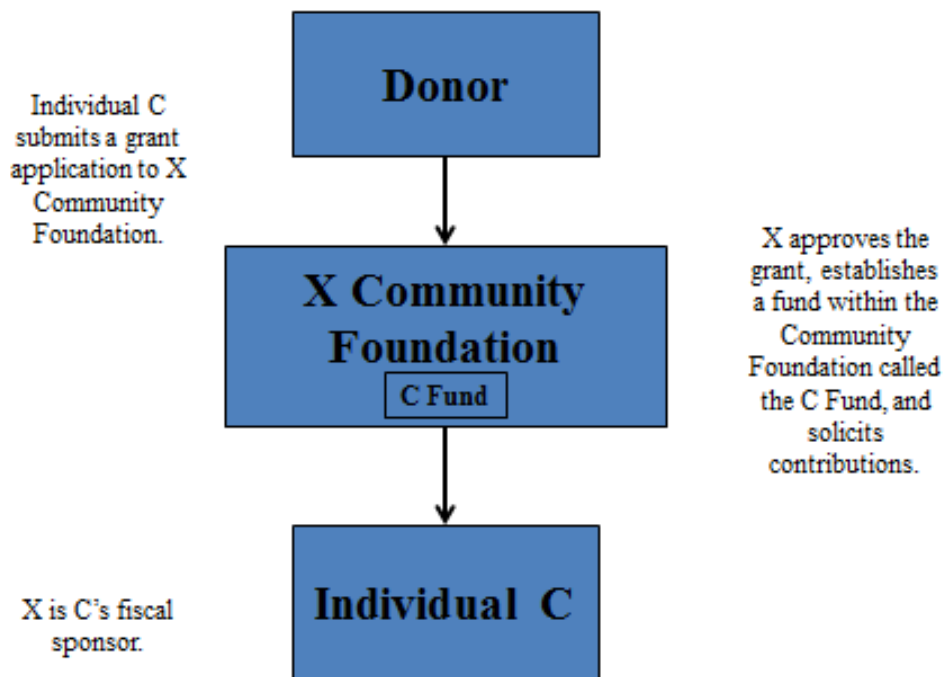
⁵² *Id.*

(NYFA), a 501(c)(3) organization, fiscally sponsors individual artists' projects in keeping with its mission to promote the arts.⁵³

3. IRS Examples of Proper Fiscal Sponsorships

The IRS itself has provided the following further examples of the proper use of fiscal sponsorships:

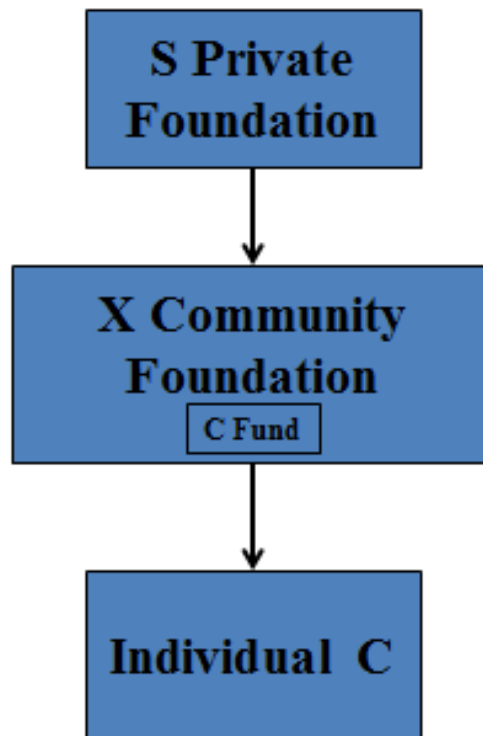
Example 1: C, an individual, desires to start a tutoring program in the inner city but does not have sufficient resources or the sophistication needed to apply for tax exemption. C submits a grant application to X Community Foundation for financial support for the tutoring program. X approves the grant, establishes a fund called the C Fund, and solicits contributions for this fund. X is C's fiscal sponsor.



Example 2: X [C]ommunity [F]oundation approaches S Private Foundation soliciting for C's fund. S makes a grant to X designated for the C Fund. S, in the instrument of transfer, gives X full control over the investment decisions concerning the grant and full discretion in determining how much and when distributions from the fund will be made.

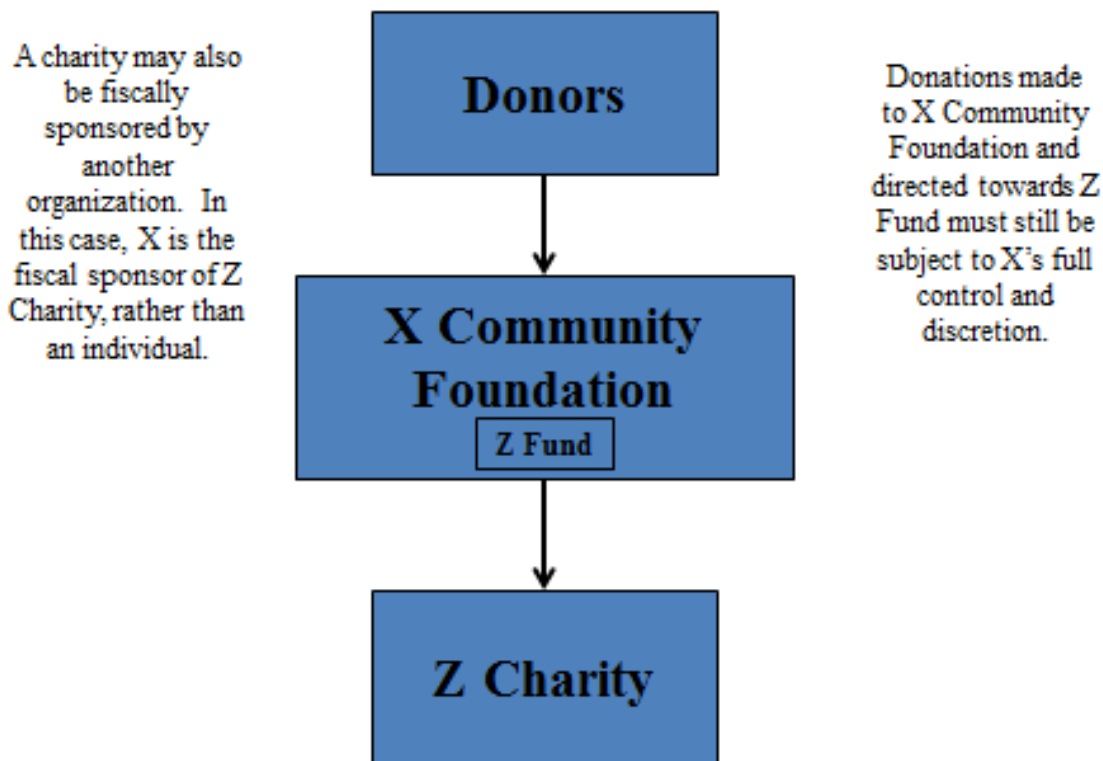
⁵³ *Donate to a Sponsored Project/Organization*, N.Y. FOUND. FOR THE ARTS, <http://www.nyfa.org/level3.asp?id=226&fid=1&sid=44> (last visited May 7, 2013).

These arrangements are also proper if a private foundation, S, makes a donation to X Community Foundation, intended for the C Fund.



S must give X "full control over the investment decisions concerning the grant and full discretion in determining how much and when distributions from the fund will be made."

Example 3: X Community Foundation receives a grant request from Z Charity. X reviews and approves the request. X establishes the Z Fund, and solicits contributions for this fund.



The IRS explained that “[i]n each of these situations, X acts as a fiscal sponsor.”⁵⁴

V. The Abuse of Fiscal Sponsorships

- ***Finding:*** While fiscal sponsorships are a useful tool for fledgling organizations, lack of oversight leaves them highly susceptible to misuse and fraud.

A. Risks of Fiscal Sponsorship Abuse

While fiscal sponsorship arrangements can be used for many legitimate reasons, experts, even those who generally support the use of fiscal sponsorship arrangements, are nearly unanimous in acknowledging that these arrangements carry significant risks of being used for fraudulent purposes. Fiscal sponsorship arrangements, if not structured and conducted properly, can have serious negative effects.⁵⁵ In particular, these arrangements have been described as attempts to “launder” funds,⁵⁶ to conceal information,⁵⁷ and to receive tax-deductible donations

⁵⁴ Johnson, *supra* note 8.

⁵⁵ Beth Kingsley & Doug Smith, *Fiscal Sponsorships: Do It Right and Stay Out of Trouble*, NONPROFIT NAVIGATOR, May 2001, available at: http://www.harmoncurran.com/?fuseaction=eUpdate.getArchives&newsletter_id=77#article2.

⁵⁶ Neal Cuthbert, McKnight Foundation, *Why We Don't Make Grants to Fiscal Agents*, 21 LEGALEASE at 2 (1997).

that organizations do not deserve.⁵⁸ These concerns about the improper use of fiscal sponsorships led the Council on Foundations to place the use of fiscal sponsorships on its list of “Top Ten Ways Family Foundations Get into Trouble.”⁵⁹

Several legal experts claim that fiscal sponsorship can be used as a “passthrough, or conduit, or laundering arrangement where the (c)(3) is really doing no more than receiving money from a donor or foundation and passing it on to a person or an organization that does not have (c)(3) status.”⁶⁰ According to John Edie, a leading nonprofit tax attorney, “Fiscal agent to me means laundering agent. If you’re going to use a fiscal agent, to me you’re saying, ‘Well, I’m going to launder the money through somebody.’”⁶¹ According to Lee Sheppard, an editor at *Tax Analysts*, “[a] fiscal agent is a money laundry. People who want to finance projects that would not, if separately incorporated, have a charitable purpose often form an exempt organization . . . to act as a conduit[] for the money used to finance the project so that its backers can claim a charitable deduction.”⁶² Sheppard goes so far to claim that “fiscal sponsorship . . . is a common practice, and one that the IRS should shut down.”⁶³

Neal Cuthbert, Vice President of the Minnesota Initiative Foundations at the McKnight Foundation, advised his foundation against making any grants to organizations using a fiscal sponsor out of fear that the funds could end up being laundered. More specifically, Cuthbert “advised the foundation not to do indirectly what it could not do directly. In other words, if the grant to the fiscal agent designated funds for a group without 501(c)(3) status, the IRS would consider that the foundation had made the grant directly to the non-exempt group and was attempting to ‘launder’ the funds.”⁶⁴ Even Gregory Colvin expressed concern that certain types of fiscal sponsorship arrangements may be used as conduits to launder money. According to Colvin, “[i]f the control mechanisms are not administered properly, [a fiscal sponsorship arrangement] can collapse into a ‘conduit’ or ‘step transaction’ in which the IRS will disregard the role of the sponsor and declare that the funding source has, in effect, made a payment directly to a non-501(c)(3) project.”⁶⁵

As Jan Masaoka, Former Executive Director of CompassPoint Nonprofit Services, has stated, “**fiscal sponsorship also offers a great opportunity for scoundrels to hide information from the public, to avoid accountability**, and for government agencies to do business without the peskiness of either the public sector unions or a real community nonprofit contractor.”⁶⁶ One of the ways that fiscal sponsorships can be used to conceal activities is by allowing private

⁵⁷ Gene Takagi, *Fiscal Sponsorship Revisited*, NONPROFITLAWBLOG.COM, <http://www.nonprofitlawblog.com/home/2009/09/fiscal-sponsorship-revisited.html> (last visited May 7, 2013).

⁵⁸ Lee Sheppard, *Charitable Money Laundering*, 8 EXEMPT ORG. TAX REV. 645 (1993).

⁵⁹ COUNCIL ON FOUNDS., TOP TEN WAYS FAMILY FOUNDATIONS GET INTO TROUBLE (2008), available at http://www.washingtongrantmakers.org/s_wash/images/client/TopTenTrouble.pdf.

⁶⁰ *Id.*

⁶¹ *Transcript of the Winter ABA EO Committee Meeting: Panel Six: The Use and Misuse of Fiscal Sponsorship*, 7 EXEMPT ORG. TAX REV. 570, 571 (1993).

⁶² Sheppard, *supra* note 58.

⁶³ *Id.*

⁶⁴ Neal Cuthbert, *Why We Don’t Make Grants to Fiscal Agents*, 21 LEGALEASE at 2 (1997).

⁶⁵ COLVIN, *supra* note 3, at 28.

⁶⁶ Gene Takagi, *Fiscal Sponsorship Revisited*, NONPROFITLAWBLOG.COM, <http://www.nonprofitlawblog.com/home/2009/09/fiscal-sponsorship-revisited.html> (last visited May 7, 2013).

foundations to avoid exercising expenditure responsibility by providing a grant to a public charity that, in turn, engages in a fiscal sponsorship arrangement.⁶⁷ Private foundations are reluctant to exercise such responsibility because they perceive it will add to their administrative costs and fear the potential tax penalties if the required procedures are not properly followed.⁶⁸ Individuals use conduit transactions to obtain tax deductions for non-charitable gifts. These individuals erroneously believe that they are entitled to a charitable deduction for giving gifts to community foundations that are earmarked for third parties.⁶⁹ However, Thomas Troyer, a nonprofit attorney, warns “[s]uch decoys do not amuse the IRS, which slaps violators with heavy tax penalties. To avoid penalties . . . foundations should ensure that public charities to whom they contribute have complete control of the money.”⁷⁰

Some have expressed concern that charities at risk of failing the public support test have misused fiscal sponsorships in order to avoid classification as private foundations, which are subject to less favorable tax rules.⁷¹ In general, charities that receive broad public support may qualify as public charities.⁷² In contrast, private foundations often are supported by only one or a small number of contributors. When determining certain organizations’ public support, a contribution by an individual generally is counted only to the extent that it does not exceed 2% of total contributions; contributions received from certain other charities, however, generally are not subject to this limit.⁷³ In other words, contributions from other charities in some cases receive favorable treatment under the public support computation.⁷⁴ Therefore, struggling charities may have an incentive to funnel large gifts that otherwise would complicate the public support computation through a separate charity, such as a publicly supported community foundation.⁷⁵

B. The IRS’s Concerns with Fiscal Sponsorships

While the IRS has refused to take action regarding fiscal sponsorship, officials have recognized that the arrangement has inherent risks. Marcus Owens, the former Director of the IRS Exempt Organizations Division, cautioned practitioners to “keep [an] . . . eye out” for potential danger zones in fund-raising efforts that involve fiscal sponsorship.⁷⁶ The IRS acknowledged that fiscal sponsorships can and have been misused, providing the example of a donor who attempts to do indirectly what he or she cannot do directly: “[s]uch a situation arises when the donor uses a community foundation as a conduit to accomplish an otherwise prohibited transfer of money or property.”⁷⁷

⁶⁷ Johnson, *supra* note 8.

⁶⁸ JOHN A. EDIE, COUNCIL ON FOUNDATIONS, USE OF FISCAL AGENTS: A TRAP FOR THE UNWARY 6 (1990).

⁶⁹ Johnson, *supra* note 8.

⁷⁰ Fred Stokeld, *Report on the 9th Annual ALI-ABA Course of Study on Tax Exempt Charitable Organizations Held on November 17-18, 1994, in Washington D.C.: Troyer on Private Foundations*, 11 EXEMPT ORG. TAX REV. 694 (1995).

⁷¹ *Thomason v. Comm’n*, 2 T.C. 441 (1943); *Tilles v. Commissioner*, 38 B.T.A. 545 (1938).

⁷² *Thomason*, 2 T.C. at 443.

⁷³ Johnson, *supra* note 8.

⁷⁴ *Id.*

⁷⁵ EDIE, *supra* note 68, at 6-8.

⁷⁶ Marlis L. Carson & John Iekel, *Official Addresses Charities’ Concerns About Substantiation Rules*, 10 EXEMPT ORG. TAX REV. 1264 (1994).

⁷⁷ *Id.*

The IRS has identified a number of examples of improper fiscal sponsorship arrangements:

- Example 1: X, a philanthropist, wants to give to Z, an individual who is poor. X knows that a transfer directly to Z lacks the necessary public benefit to be considered charitable. X would not be entitled to a charitable tax deduction. To avoid this result, X donates money to Y Community Foundation with instructions to distribute it to Z. Y has no discretion as to the distribution of the funds. Here, Y is nothing more than a conduit. X is not entitled to a deduction.
- Example 2: C, a private foundation, wishes to support a non-exempt charitable project. (A non-exempt project, as used in this context, is a charitable activity of an organization that does not have an IRS determination letter.) C does not want the burden of exercising expenditure responsibility, but wishes to maintain continuing supervision of the project. C gives the money to Y Community Foundation after Y has agreed that C will maintain continuing control and that the money will be used solely for the project.
- Example 3: S, a fledgling organization, is struggling to maintain public charity status. T, a wealthy donor, wants to give S a large contribution. If T gives it directly to S, the contribution will be subject to the 2% of total support limitation and S would fail the public support test. To avoid this, T "earmarks" the money for S and runs it through the Y Community Foundation. Y has no discretion but to distribute the money to S.

The IRS analyzed these examples by stating that Y Community Foundation had no control over the donations and therefore acted as a mere conduit in a transfer between the donor and the ultimate recipient, who were the only beneficiaries in the transactions.⁷⁸

C. Frequent Abuse of Fiscal Sponsorships

Unfortunately, the abuse of fiscal sponsorships is a common occurrence. Kenneth Brier, a widely-acknowledged expert in nonprofit tax law, has claimed “**I have seen so many charities think that if you funnel money through somebody who’s got a 501(c)(3) status that there’s just no problem.** I’ve seen private foundations spend money earmarked for lobbying, but think they had no problem because they sent it through a (c)(3) public charity, and I’ve seen private foundations spend money for other non-charitable purposes but think they didn’t have a problem because the money was funneled through a (c)(3) public charity.”⁷⁹ According to John Edie, “[m]ost uses of a fiscal agent do not square with the [IRC] and present potential problems and possible penalties for individual donors, private foundations, company foundations, community foundations and other public charities.”⁸⁰ Fractured Atlas, an organization which specializes in

⁷⁸ *Id.*

⁷⁹ Kenneth Brier, *The Use and Misuse of Fiscal Sponsorship Arrangements*, 7 EXEMPT ORG. TAX REV. 570 (1993).

⁸⁰ EDIE, *supra* note 68, at 1.

fiscally sponsoring artists and art organizations,⁸¹ has also added its concerns that fiscal sponsorships are frequently misused:

Many well-intentioned, legitimate organizations across the country provide fiscal sponsorship programs for artists. **Very few of them are doing it legally, though**, and most don't even realize the danger in which they're putting themselves and their sponsored projects. If the IRS ever decides to crack down, they could lose their 501(c)(3) status, and their sponsored projects could be forced to return any money raised under the arrangement.⁸²

Unfortunately, this frequent abuse of fiscal sponsorships has had the effect of needlessly tying up the IRS regulatory system. According to the *American Journal of Tax Policy*, "IRS service centers are currently unable to provide timely responses to requests for information returns. Nor are they able internally to follow up on incomplete returns and missing returns in a swift manner."⁸³ A research report sponsored by the Nonprofit Coordinating Committee of New York states that these IRS failures were due, in large part, to fiscal sponsorships:

As an example of the serious data reporting and follow-up problems, a 1992 report noted that when 24,211 organizations listed in a New York survey were compared to 19,721 on the IRS file, the New York list contained more than 10,000 not on the IRS list, and the IRS contained 9,000 not on the New York list. **Many of the inconsistencies were due, not simply to nonfiling with IRS, but to fiscal sponsorship of one group by another and similar problems.**⁸⁴

Greg Yardley of *FrontPage Magazine* adds that certain organizations are "abusing and stepping beyond the boundaries of non-profit law in order to fund their activities, activities that most certainly do not provide a 'public benefit.'"⁸⁵ These organizations "know that the list of non-profit organizations in America is two thousand pages of tiny type, and the IRS, understaffed and underfunded, lacks the resources to investigate every organization in depth."⁸⁶ Therefore these organizations "choose to break the law; a calculated risk. Their primary method is the abuse of a variety of *fiscal sponsorship*, a procedure which allows an unregistered project to obtain tax-deductible contributions through a non-profit intermediary."⁸⁷

⁸¹ *We Help Raise Funds For Creative Projects*, FRACTURED ATLAS, <http://www.fracturedatlas.org/site/fiscal/> (last visited May 24, 2013).

⁸² *Fiscal Sponsorship*, FRACTURED ATLAS, <http://www.fracturedatlas.org/site/fiscal/> (last visited May 7, 2013).

⁸³ C. Eugene Steurele & Martin A. Sullivan, *Toward More Simple and Effective Giving: Reforming the Tax Rules for Charitable Contributions and Charitable Organizations*, 12 AM. J. TAX POL'Y 399, 445 (1995).

⁸⁴ NANCY HAYCOCK & ROSEMARY SCANLON, *THE NONPROFIT SECTOR IN NEW YORK CITY* 4 (1992).

⁸⁵ Greg Yardley, *Deductions for Destruction*, FRONTPAGE MAGAZINE (Aug. 6, 2003), <http://archive.frontpagemag.com/readArticle.aspx?ARTID=16903>.

⁸⁶ *Id.*

⁸⁷ *Id.*

VI. Fiscal Fraud

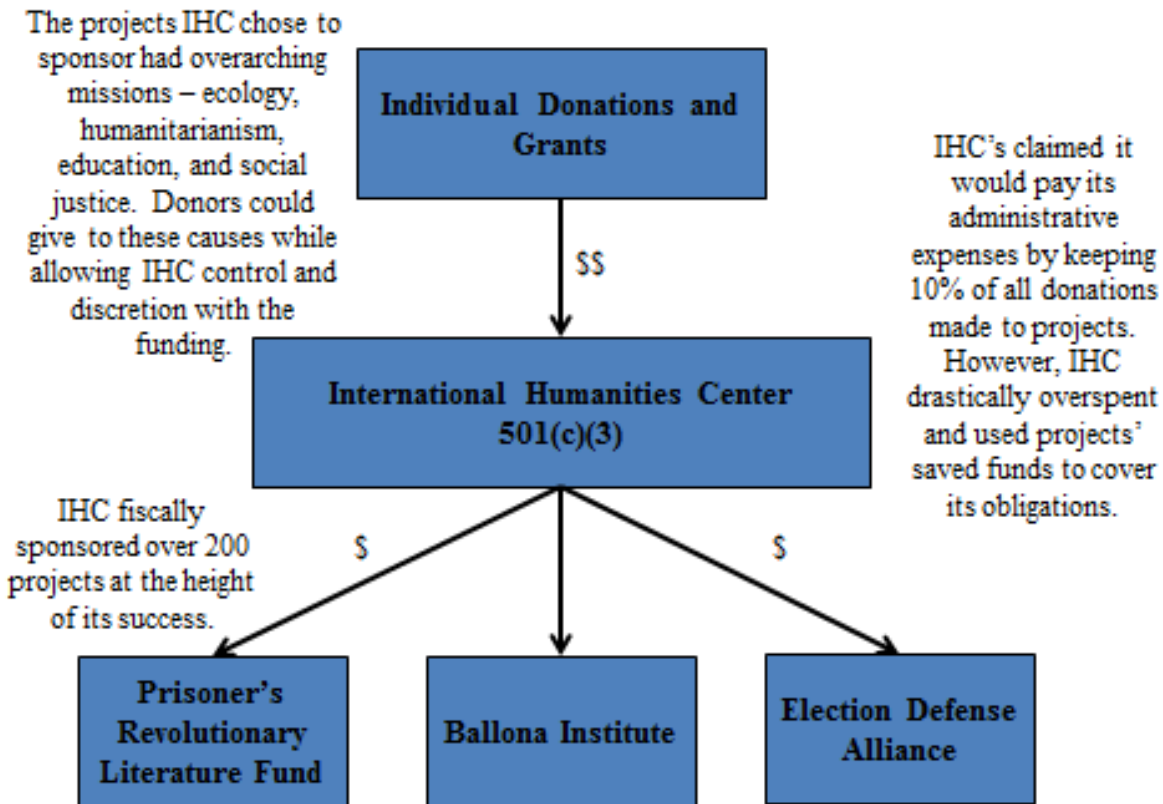
- ***Finding:*** The International Humanities Center (IHC) abused its discretion as a fiscal sponsor, making poor business decisions and improperly using its projects' funds as a means to pay off debts. This resulted in it losing almost \$1 million in project funding.
- ***Finding:*** While the Department of Energy (DOE) opened an investigation upon learning from Cause of Action that the Ballona Institute received money directly from the Los Angeles Department of Water and Power (LADWP), the status of that investigation is unknown. According to information Cause of Action received, a criminal and civil case was pending against IHC as of April 2012 and DOE was considering debarring high-level IHC officials. Despite DOE's apparent enforcement action against IHC, it is nevertheless true that DOE's failure to oversee grant funds allowed IHC to commit fraud against projects. For instance, in response to a Freedom of Information Act (FOIA) request from Cause of Action, DOE stated that it had no records or applications relating to the LADWP subgrant. The FOIA officer instead stated that DOE does not follow grant money once it is given to the direct awardee. Had DOE been aware of the subgrant to Ballona, it might have realized that IHC was in serious financial trouble and was not qualified to receive a grant on behalf of Ballona. DOE's failure to oversee its grant process therefore enabled IHC to mismanage federal grant funds.
- ***Finding:*** Help Is Here, Inc. (HIH) abused its control as a fiscal sponsor by "preying upon" projects, improperly seizing funds for projects, refusing to disburse funding to projects, and attempting to wrest control over projects which attempted to leave.
- ***Finding:*** Christian Community, Inc. (CCI) abused both projects and taxpayers by fraudulently posing as a "fiscal sponsor" for twenty years. Tax documents, audits, and bank statements were fabricated and over \$400,000 in project funding was lost.

A. International Humanities Center: "Not a System that Required Accountability"

IHC was, until January 2011, a large-scale fiscal sponsor in Pacific Palisades, California, run by Executive Director and founder Steve Sugarman. The mission statement previously available on IHC's website refers to it as a "501(c)(3) charitable trust that specializes in providing comprehensive fiscal sponsorship services to charitable initiatives operating all over the world."⁸⁸ At the height of its success, IHC was sponsor to an estimated 300 projects, and continued to sponsor over 200 charitable endeavors until its collapse, making it a highly

⁸⁸ INTERNATIONAL HUMANITIES CENTER, <http://web.archive.org/web/20110726172456/http://www.ihcenter.org/welcome> (last visited May 7, 2013).

successful fiscal sponsor and creating significant buzz in the nonprofit sector.⁸⁹ In December 2011, however, some projects received a letter from Sugarman acknowledging that IHC was “running a considerable deficit that has severely impacted all operations,” and warning the projects that future payments may not be processed; one month later Sugarman informed some of these projects that IHC would be shutting down. The rest of the projects remained unaware that their sponsor—and all their donations—would soon be gone.



An analysis of IHC’s collapse reveals inherent problems in its structure. For example, IHC consultant David DelGrosso complained that Sugarman was a “lousy businessman.” Sugarman’s expertise in humanitarianism and activism did not extend to running the finances of an operation whose goal it was to financially support hundreds of projects. IHC’s structure and operation as a fiscal sponsor instead contributed to the ruin of many former projects. While IHC received donations on behalf of its non-501(c)(3) charitable projects, project directors did not receive any updates on accounting or submitted donations. DelGrosso contended that directors were aware that they could request account information at any time and clarified that while projects were not regularly updated, IHC management kept exhaustive ledgers detailing every donation and disbursement made to each of the projects. Nevertheless, there was no system in place for relaying this information to the projects themselves—the true amount of funding lost in IHC’s collapse remains unknown due to projects’ constant ignorance of their own status.

⁸⁹ Joan Brunwasser, *Talking with Steve Sugarman of International Humanities Center*, OPEd NEWS (Nov. 9, 2009, 7:17 PM), <http://www.opednews.com/articles/Talking-with-Steve-Sugarman-by-Joan-Brunwasser-091109-375.html>.

The structural problems in accountability and communication allowed IHC to continue in this manner for over nine years, all the while improperly spending tax-exempt donations to charitable projects on elaborate office space and technology. Accountability with project funds and communication regarding the amount of funds a project currently held in the IHC bank account could have alerted projects to Sugarman's irresponsible spending and prevented the situation from escalating to an estimated \$1 million in losses. However, IRS regulations have little to say about IHC's arrangements. Though there was no requirement for accountability in informing the projects of how their donations were being spent, Sugarman nevertheless took advantage of his role as a sponsor and abused project funds by thwarting donor intent through administrative overspending. Sugarman's so-called mismanagement has even been publicly referred to as a Ponzi scheme, since donations were immediately seized to cover IHC's pressing bills while Sugarman frantically searched for new grants and projects to belatedly replenish the funds.⁹⁰

Though IHC's overall structure was not necessarily illegal, the organization may or may not have been upholding the laws governing sponsored projects' individual transactions. In one case, a project of IHC named the Ballona Institute (Ballona) received federal funding through the American Recovery and Reinvestment Act of 2009 after a subgrant from the Los Angeles Department of Water and Power (LADWP) was awarded to the project. IHC, as the federally- and state-recognized 501(c)(3), was required to accept nonprofit donations on behalf of its non-501(c)(3) projects, including Ballona. While IHC ultimately received the federal funding on behalf of Ballona, a copy of the check LADWP sent to Ballona indicates that it was not made out to IHC, but rather to Ballona.

While the Department of Energy (DOE) opened an investigation upon learning from Cause of Action that the Ballona Institute received money directly from the LADWP, the status of that investigation is unknown.⁹¹ According to information Cause of Action received, a criminal and civil case was pending against IHC as of April 2012 and DOE was considering debarring high-level IHC officials.⁹² Despite DOE's apparent enforcement action against IHC, it is nevertheless true that DOE's failure to oversee grant funds allowed IHC to commit fraud against projects. For instance, in response to a Freedom of Information Act (FOIA) request from Cause of Action, DOE stated that it had no records or applications relating to the LADWP subgrant.⁹³ The FOIA officer instead stated that DOE does not follow grant money once it is given to the direct awardee. Had DOE been aware of the subgrant to Ballona, it might have realized that IHC was in serious financial trouble and was not qualified to receive a grant on behalf of Ballona. DOE's failure to oversee its grant process therefore enabled IHC to mismanage federal grant funds.

⁹⁰ Cohen, *supra* note 16.

⁹¹ E-mail between Cause of Action Staff (Apr. 27, 2012, 11:33) (on file with author) (discussing conversation with Special Agent Shawn Dionida of DOE).

⁹² *Id.*; *see* Letter from John R. Hartman, Acting Assistant Inspector General for Investigations, Office of Inspector General, DOE, to Cause of Action (Mar. 12, 2012) (stating that responsive documents are being withheld pursuant to Exemption 7(A)).

⁹³ E-mail between Cause of Action staff (Apr. 2, 2012, 1:49 PM) (on file with author) (memorializing conversation with DOE FOIA officer); Letter from Carol Battershell, Manager, Golden Field Office, DOE, to Cause of Action (Mar. 28, 2012) (stating that there are no responsive documents regarding the LADWP subgrant).

Despite all the individuals involved in this process, neither IHC management, nor Ballona Institute directors, nor state officials charged with disbursing the funds properly managed the transaction. Moreover, IHC's apparent subversion of donor intent through its mismanagement of funds raises the question of whether federal funding was misused. Federal grants to fiscally-sponsored projects receive little oversight by the federal government, which generally does not devote resources to examining disbursements of such a small size. Because fiscally-sponsored projects also receive little oversight from their fiscal sponsors, no entity ensures that taxpayer funding is used properly, and any amount of funding has the potential to be misused.

Ballona's apparent ignorance of 501(c)(3) requirements was not unique; DelGrosso reported that another one of his duties as a consultant was to work with project directors whose proposed activities were non-501(c)(3) compliant. Project directors contacted by Cause of Action reported a drastic increase in the difficulty of getting funds released from IHC for proposed activities after DelGrosso replaced Sugarman as their main point of contact. The significant change in availability of funds, coinciding with DelGrosso's arrival and focus on 501(c)(3) compliance, suggests that prior to DelGrosso's tenure at IHC, Sugarman was not stringent with 501(c)(3) requirements for project activities, instead allowing projects the leeway to conduct non-exempt activities with tax-exempt donations. Projects tended to have little oversight from their fiscal sponsors, which in turn have little oversight from the federal government; this makes any level of accountability for taxpayer funding donated to these projects impossible.

Not only does a potential lack of enforcement of 501(c)(3) compliance endanger taxpayer funding, but it also compromises the availability of tax-exempt donations to all projects under the fiscal sponsor of the non-compliant project. As referenced above in the case of *Better Business Bureau of Washington, D.C., Inc. v. United States*, the presence of a single non-exempt purpose will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. A lack of oversight by the fiscal sponsor can therefore endanger the exempt status of compliant projects due to the presence of separate projects which are conducting non-compliant activities, endangering the charitable projects themselves. Proper oversight of the projects' compliance with 501(c)(3) regulations is required in order to uphold duties to both the donor and the donee.

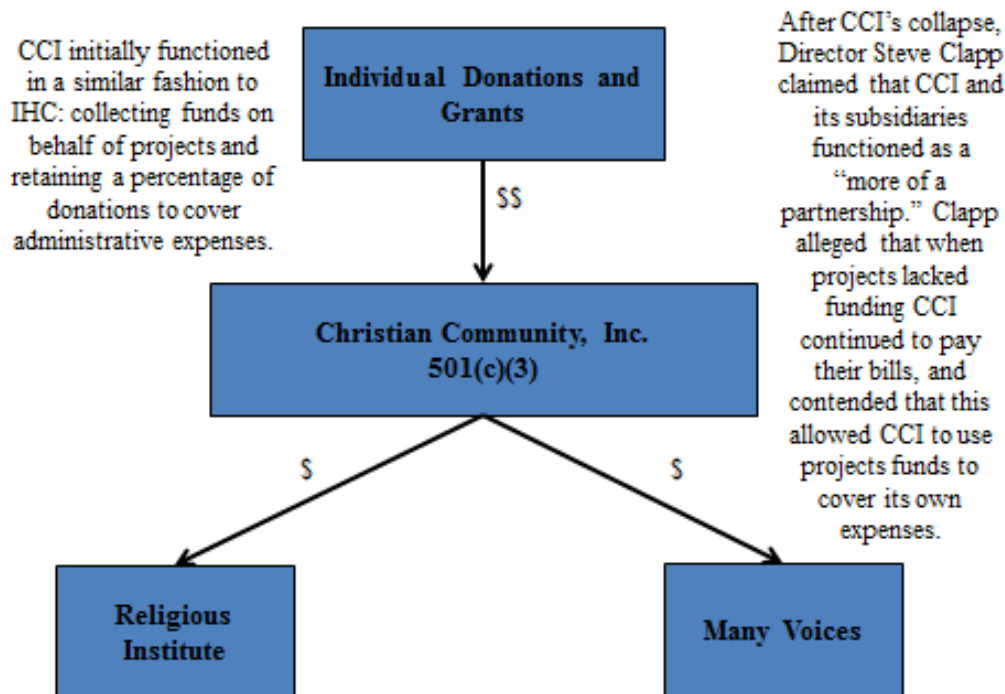
As a result of the lack of oversight and accountability, over 200 charitable projects which formerly operated under IHC's 501(c)(3) exemption lost an estimated total of \$1 million. This number, however, does not cover the real cost of IHC's fraud: the financial infrastructures of IHC's projects were decimated. Kenny Johnson of former IHC project This Sacred Space lost his donors entirely, referring to their formerly strong relationship as "irreparably damaged." Sally Castleman, Director of the Election Defense Alliance, also lost her donors; they attributed the theft of the group's funding to "bad judgment" on Castleman's part for choosing to work with a fiscal sponsor. Peaceful Uprising, another IHC project, was "left . . . unable to pay [its] small staff, rent for [its] space, or any other expenses."⁹⁴

⁹⁴ Rick Cohen, *Vanishing Act: Activist Groups Say Donations Disappeared with Fiscal Sponsor*, NONPROFIT QUARTERLY (Feb. 3, 2012), http://www.nonprofitquarterly.org/index.php?option=com_content&view=article&id=19616:vanishing-act-activist-groups-say-donations-disappeared-with-fiscal-sp.

Ironically, former IHC employees report that IHC was undergoing an audit by the IRS at the time of its collapse, and that the IRS had filed a \$69,570 tax lien against IHC.⁹⁵ The IRS had not concluded its examination of IHC by before it shut down. DelGrosso reported that the IRS attempted to schedule its next appointment at IHC offices in February or March 2012, after IHC has already shut down. DelGrosso believed the IRS discovered “serious issues” within IHC, but even so, had focused on smaller issues and missed the fundamental problem which plagued IHC: uncontrolled and unaccountable spending.

B. Christian Community, Inc.: From Financial Felon to Fiscal Sponsor

In Fort Wayne, Indiana, just a month after IHC made the decision to shut down its operations, a small fiscal sponsor called CCI informed its two projects that it too would close its doors. Reverend Steven Clapp, the director of the fiscal sponsor, claimed that “there was never any intention to betray,” and that “there is a significant difference between, I’ll use the words ‘mismanagement’ and ‘incompetency’—both of which I’m guilty of—and intentionally taking advantage of or harming others.”⁹⁶ Clapp hoped to present a case to his projects and to the public that he had simply been a “lousy businessman.” In reality, Clapp’s foray into fiscal sponsorship actually provided an outlet for him to continue the financial fraud of his previous life.



⁹⁵ Jeff Gottlieb, *Nonprofits Fear Money in Center's Care Vanished*, L.A. TIMES, Feb. 14, 2012, available at <http://articles.latimes.com/2012/feb/14/local/la-me-missing-money-20120214/2>.

⁹⁶ Stockman, *supra* note 17.

Clapp joined CCI in 1993, two years after it received federal nonprofit status. After spending over four years in prison for bank fraud in Illinois because he forged financial statements in order to obtain loans to support his business, Clapp moved to Fort Wayne, Indiana and quickly took an active role in CCI.⁹⁷ Reverend Debra Haffner, President of the Religious Institute,⁹⁸ a project of CCI until its collapse, worked with Clapp through CCI for over ten years. The organizations grew so close Haffner even asked Clapp to serve on the board of the Religious Institute.⁹⁹

Though CCI's projects had no reason to suspect impropriety, the state and federal officials charged with oversight of nonprofit organizations received several signals that CCI was not functioning properly. CCI lost its nonprofit status for the final time in a notice from the IRS sent February 22, 2012 because Clapp had failed to file a tax return for CCI three years in a row. Similarly, Indiana dissolved CCI's incorporation in 2005, also after Clapp failed to file annual reports for three years in a row.¹⁰⁰ The corporation was reinstated just two months later.¹⁰¹

Examination of the few available Form 990s which CCI filed with the IRS show that Clapp made conflicting claims to the IRS and to his projects. Haffner stated that Clapp assured her that CCI had a board of advisers, but Clapp was the only individual listed anywhere on the IRS filings he submitted for CCI: no officers, directors, trustees, employees, or independent contractors were listed. Haffner detailed her meticulous requests for documentation regarding the Religious Institute's arrangements with CCI, which Clapp acquiesced to by providing fraudulent documents, including (1) an annual Form 990 for CCI with the Religious Institute included as a fiscally sponsored project, (2) W-2's for all Religious Institute employees, and (3) audits of CCI. In reality, the Form 990s that Clapp provided to the IRS did not list any of CCI's projects. Neither were any of the alleged W-2's legitimate. Though Clapp had withheld Social Security contributions and taxes from the Religious Institute employees, Haffner reported that these withholdings were "never tied out to any real money submitted to the federal government." Haffner found no record of Social Security withholdings or taxes ever having been received by the proper agencies. Further, the accountant who signed the audit was not licensed in Illinois, as the audit claimed, or in Indiana,¹⁰² while the audits and bank statements turned out to be, according to Haffner, "nothing but fake colored pieces of paper."¹⁰³ However, the projects supported by CCI do not appear to have had any warning that their funds were not being spent properly. There were no alarm bells or suspicious interactions with Clapp.

The regulations of fiscal sponsors are demonstrably few, but CCI repeatedly proved it was unable to uphold even these requirements by failing to file simple statements regarding its activities. The entire organization was run by a man convicted of several felonies relating to

⁹⁷ Dan Stockman, *Reverend Who Lost Money Has Criminal Past*, J. GAZETTE, Apr. 1, 2012, available at <http://www.journalgazette.net/article/20120401/LOCAL10/304019948>.

⁹⁸ *The Rev. Debra Haffner*, Religious Institute, <http://www.religioustheology.org/staff/the-rev-debra-w-haffner> (last visited May 24, 2013).

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ Telephone Interview by Cause of Action Staff with Rev. Debra Haffner, Exec. Dir., Religious Inst. (Apr. 15, 2013).

financial fraud. Clapp even began asking project directors and affiliates to invest their 401(k) savings in projects, promising larger than normal returns for participation.¹⁰⁴ CCI was riddled with red flags, but the organization went unquestioned for nearly twenty years. As with IHC, Clapp was the sole individual with knowledge of projects' account balances, donation history, and financial transactions. Only an estimate of projects' losses can be compiled, but the total appears to be between \$600,000 and \$700,000.¹⁰⁵ Both the Indiana Attorney General and the FBI reportedly began investigating CCI's fraud, but it is not clear whether the investigations are ongoing.¹⁰⁶

The public reactions of both Clapp and Haffner to the news of CCI's demise best express the problems arising from the lack of law governing fiscal sponsorship. In an interview with the *Fort Wayne Journal Gazette*, Clapp acknowledged that CCI deviated from accepted forms of fiscal sponsorship but refused to define the exact model due to his "pending legal issues."¹⁰⁷ Clapp did note, however, that "the model Christian Community used was more of a partnership, where Christian Community would pay projects' bills even if the project didn't have money to cover them at the time . . . [a]nd since it was a partnership, Clapp said, when the money was used to pay Christian Community expenses, they were really everyone's expenses."¹⁰⁸ Clapp applied a loose interpretation of the relationship between a sponsor and project in an attempt to justify his fraudulent practices.

Though Clapp responded to CCI's shutdown by defending the model of fiscal sponsorship he had created, the defrauded organization had a different reaction. Haffner reversed her long-standing opinion on the practice of fiscal sponsorship as a whole; after an eleven-year experience with fiscal sponsorship, Haffner noted that projects "should only use fiscal agents for the shortest period of time" in all cases. After a brief association with a fiscal sponsor, if a project has proven its worth and stability, Haffner recommends that projects ensure their own security by becoming federally-recognized nonprofits in their own right. Accordingly, the Religious Institute has taken on a new, short-term fiscal sponsor and is in the process of applying for its own nonprofit status. This new attitude regarding fiscal sponsorship is much more in accordance with the existing IRS regulations regarding fiscal sponsorship, which use as examples temporary projects which will either be entirely transient or which are in the midst of applying for recognition as an independent nonprofit organization.

C. Help Is Here, Inc.: "Professional Gypsy Scam Artists"

While overly extensive discretion with earmarked funding can lead to confiscation of project funds, another failed fiscal sponsorship was instead characterized by too much control over the projects it fiscally sponsored. HIH was founded as fiscal sponsorship organization,

¹⁰⁴ *Id.*

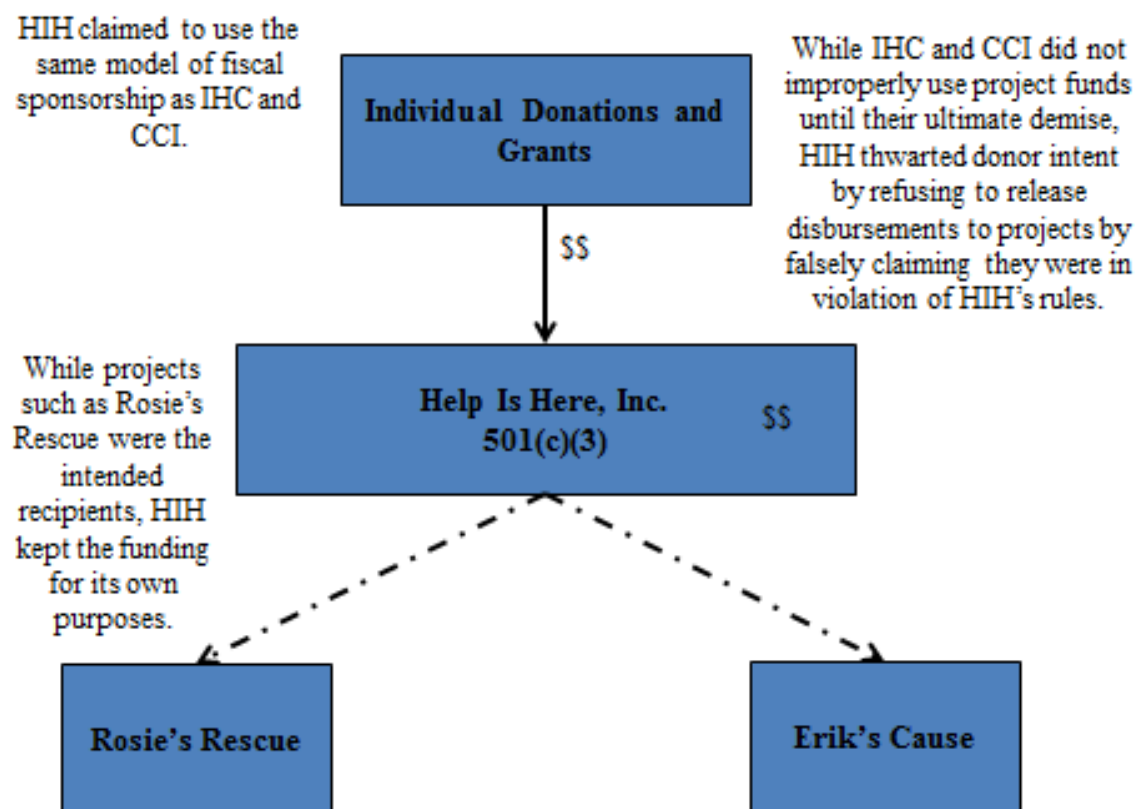
¹⁰⁵ Stockman, *supra* note 17.

¹⁰⁶ Clapp passed away on May 15, 2012 as a result of an apparent suicide. The Journal Gazette reported that "A police report said that Clapp had been depressed "due to financial and legal problems" but had not made any mention of killing himself . . . no signs of foul play were found." Dan Stockman, *Embattled Cleric's Death Ruled Suicide*, J. GAZETTE, May 17, 2012, available at <http://www.journalgazette.net/article/jg/20120517/LOCAL/120519544/1002>.

¹⁰⁷ Stockman, *supra* note 96.

¹⁰⁸ *Id.*

incorporated in California in 2007, purportedly to “facilitate the Community Spirit in start-up organizations that are passionately changing the communities they live in both locally and globally, whether it be Environmental, Humanitarian, or Educational by affording the tool [sic] and resources that seasoned 501c3 [sic] nonprofits have.”¹⁰⁹ Bill Mack, the founder and original Chief Executive Officer (CEO) of HII, stepped down from his position and moved to a smaller role as Operations Director in early 2011,¹¹⁰ handing over control of HII to Maggie Lane-Baker as the new CEO. Projects of HII reported that problems first began to arise when Lane-Baker arrived at HII.



Lane-Baker’s tenure as director of HII was marked by the confiscation of donations to projects, attempted seizure of entire projects, avoidance of project managers, and missed court appearances in lawsuits against the organization. Some of the problems are similar to those found with other fiscal sponsors, in particular, the lack of accountability regarding donation submissions and the projects’ account balance information. Unlike IHC and CCI, however, HII

¹⁰⁹ HELP IS HERE, INC., <http://web.archive.org/web/20120621020526/http://helpishereinc.org/> (last visited May 1, 2013).

¹¹⁰ *Bill Mack*, LINKEDIN, http://www.linkedin.com/profile/view?id=55616237&authType=OUT_OF_NET_WORK&authToken=Oara&locale=en_US&srchid=ac5d97e6-7592-4694-b361-0e3b44fad4f8-0&srchindex=1&srchtot=2&goback=%2Efps_PBCK_*1_*1_*1_*1_*1_*1_*1_994742_*1_Y_*1_*1_*1_false_1_R_*1_*51_*1_*51_true_*1_*2_*2_*2_*2_*2_994742_*2*&pvs=ps&trk=pp_profile_photo_link (last visited May 7, 2013).

went a step further and actively frustrated project donations. HIIH's Standard Operations Manual claimed that "[o]nline contributions placed via the HIIH Inc. website payment system will generate immediate acknowledgment messages back to the donor's email address."¹¹¹ Project directors, however, reported not receiving notification of donations to their projects. Judy Rogg, Project Director of Erik's Cause, initially received notifications of website donations, but this practice suddenly stopped in December 2011, and she accordingly disabled her online donations. Lane-Baker charged Rogg with being "out of compliance" and ordered her to reinstate online donations, but refused to disburse funding from the Erik's Cause account to do so.¹¹² Maryanne Garon of Gregg's Goals contended that "[w]e were never given any accounting from [Lane-Baker] . . . though we asked nearly every month." Lane-Baker eventually changed the policy, demanding that in order for funds donated online to be disbursed to a project, the project director must report the donation within 24-48 hours of its submission, requiring the director's prior knowledge of any donation made to its organization.¹¹³ If not reported, the donation was seized and went to HIIH's general fund.

Former projects of HIIH were victimized by Lane-Baker's practices. Online reviews by former project directors of HIIH and Lane-Baker personally display the damage HIIH's abuse caused. A review of HIIH by Rogg warned, "DO NOT TRUST THESE PEOPLE – THEY ARE SCAM ARTISTS."¹¹⁴ Another anonymous review noted that the individual "was really suckered in at how nice she was until I put money into her PayPal account . . . I have not been able to get ANY response from her."¹¹⁵ A third angry submission from a project meant to "help people who have sustained Brain Injuries [sic]" charged that "Maggie Baker is a liar and a thief."¹¹⁶ Garon said of the "Standard Operating Manual," the document which laid out the requirements for all projects, it "was not provided to us when we signed up. It was something Maggie cooked up later, and she kept changing it to try to 'get us.'"¹¹⁷ The constantly-changing manual seems to be strategic for Lane-Baker, as violations of the manuals were cause, according to HIIH, for the confiscation of project funds. Lane-Baker seized donations from Jennifer Gurecki's project Zawadisha Fund because the project "didn't follow procedure"¹¹⁸ but a review of HIIH on behalf of the Zawadisha Fund contended that "Help Is Here Inc. has not fulfilled any of their duties as our fiscal sponsor. To date they have not acknowledged receipt of our donations, nor have they disbursed these funds to our project."¹¹⁹ In a lawsuit brought by

¹¹¹ *Standard Operations Manual*, HELP IS HERE, INC., <http://web.archive.org/web/20111008080159/http://helpishereinc.org/docs/som.pdf> (last visited May 7, 2013).

¹¹² Marjorie Beggs, *Erik's Cause Wins Suit Against HIIH*, FISCAL SPONSOR DIRECTORY (Sept. 7, 2012), <http://www.fiscalsponsordirectory.org/news.php>.

¹¹³ Wayne Heuring, *Scholarship Fund Out \$7,900*, FISCAL SPONSOR DIRECTORY (Sept. 7, 2012), <http://www.fiscalsponsordirectory.org/news.php>.

¹¹⁴ *Help Is Here, Inc.*, GREAT NONPROFITS (Sept. 29, 2012), http://greatnonprofits.org/reviews/help-is-here-inc#r_id-123877--user_id-158607.

¹¹⁵ *Help Is Here, Inc.*, GREAT NONPROFITS (Dec. 16, 2012), http://greatnonprofits.org/reviews/help-is-here-inc#r_id-146809--user_id-193815.

¹¹⁶ *Help Is Here, Inc.*, GREAT NONPROFITS (July 3, 2012), http://greatnonprofits.org/reviews/help-is-here-inc#r_id-117661--user_id-159962.

¹¹⁷ Heuring, *supra* note 113.

¹¹⁸ Link, *supra* note 18.

¹¹⁹ *Help Is Here, Inc.*, GREAT NONPROFITS (Feb. 5, 2012), http://greatnonprofits.org/reviews/help-is-here-inc#r_id-106054--user_id-142646.

Gurecki in the Placer County Superior Court in California, HIH was required to return \$4,952 to its former project.¹²⁰

HIH not only attempted to seize donations, but also claimed control over the charitable projects themselves. Rogg also attempted to end her agreement with HIH, but this request was denied by the organization, which refused to take down Erik’s Cause from the HIH website. In an interview with *Fiscal Sponsor Directory*, Lane-Baker acknowledged that she confiscated \$50,000 in funding, including donations to Zawadisha Fund, Gregg’s Goals, and Erik’s Cause, but claimed that HIH has “the right to absorb the funds and shut down the projects if . . . we deem they are not in compliance with IRS regulations.”¹²¹ Rogg filed a lawsuit in Los Angeles County’s small claims court in August 2012. Although Lane-Baker refused to attend the proceedings,¹²² founder Bill Mack attended on behalf of HIH.¹²³ During the proceedings, HIH’s abusive relationship with its projects became evident, prompting the judge to ask Mack, “Are you preying on these projects?”¹²⁴ Rogg won the lawsuit and HIH was ordered to remove Erik’s Cause and active donation buttons to the project from its website and to return \$4,637 in funding to a new fiscal sponsor working with Erik’s Cause.

VII. Fiscal Sponsorship as an Industry: ACORN’s Institutionalization of Corruption

- ***Finding:*** ACORN and rebranded ACORN organizations and affiliates used fiscal sponsors as conduits to receive tax-exempt funds for partisan activities.
- ***Finding:*** IHC and AISJ potentially abused taxpayer funding. IHC may have mismanaged a federal grant intended for its project the Ballona Institute, while AISJ’s fiscal sponsorship of ACORN brings grants it received from the Department of Justice into question.
- ***Finding:*** Fiscal sponsorship has grown into its own industry in which large-scale fiscal sponsors act as business operations rather than charitable institutions.

A simple internet search makes clear that fiscal sponsorship has by now grown into a sizeable industry. There are national organizations which guide and govern fiscal sponsors large and small, most of which point to Colvin’s work in defining the acceptable models of fiscal sponsorship and how it should function. The National Network of Fiscal Sponsors cites Colvin’s *Fiscal Sponsorship: 6 Ways to Do It Right* as the “most comprehensive legal discussion” of the practice;¹²⁵ the National Council of Nonprofits’ section on fiscal sponsorship recommends

¹²⁰ Geoff Link, *Judges Are Listening to Abused Projects*, FISCAL SPONSOR DIRECTORY (Sept. 7, 2012), <http://www.fiscalsponsordirectory.org/news.php>.

¹²¹ Geoff Link, *Help Is Here CEO Responds*, FISCAL SPONSOR DIRECTORY (Aug. 2, 2012), <http://www.fiscalsponsordirectory.org/news.php>.

¹²² Telephone Interview by Cause of Action Staff with Kay Mosko, Dir., Rosie’s Rescue (Apr. 3, 2013).

¹²³ Beggs, *supra* note 112.

¹²⁴ *Id.*

¹²⁵ *Models of Fiscal Sponsorship*, NAT’L NETWORK OF FISCAL SPONSORS, <http://www.fiscalsponsors.org/pages/models-fiscal-sponsorship> (last visited May 7, 2013).

Colvin's work;¹²⁶ and the Fiscal Sponsor Directory claims it is "the inspiration of *6 Ways* author, attorney Greg Colvin, [who] has provided guidance and expertise" in its development.¹²⁷

Colvin, the formative contributor to the fiscal sponsorship industry, also has ties to the notably corrupt fiscal sponsorship organization ACORN. Colvin is counsel to the Alliance of Californians for Community Empowerment (ACCE), the rebranded California chapter of ACORN.¹²⁸ The brand of fiscal sponsorship developed by ACORN and espoused by Colvin has come under investigation by the U.S. House Committee on Oversight and Government Reform (Oversight Committee) for the abuse of fiscal sponsorship laws and IRS regulations against money laundering.¹²⁹ ACORN created a vast network of nonprofit organizations, still operational today but without the guidance of the national organization, which fiscally sponsor one another in order to circumvent restrictions on tax-exempt donations and lobbying.

A. ACORN's Conduit Funding

ACORN was established in 1970 by activist Wade Rathke in Little Rock, Arkansas.¹³⁰ At the time of its collapse in 2010, ACORN was an organization with hundreds of affiliates, both nonprofit and for-profit organizations, registered in forty-one states.¹³¹ The national organization functioned as an association of many local and state chapters. Revelations of rampant, institutional voter fraud, unreported embezzlement by the founder's brother, Dale Rathke, and allegations of political activity led Congress to pass legislation which prohibited federal taxpayer money from funding ACORN.¹³² Several subsequent investigations by the Oversight Committee found that ACORN used its complex organizational structure in order to illegally move money between tax-exempt and non-exempt organizations, preventing accountability for the taxpayer funding ACORN received and allowing taxpayer money and tax-exempt donations to fund political activity.

The Oversight Committee, in a February 2010 report entitled "Follow the Money: ACORN, SEIU, and their Political Allies,"¹³³ found that:

- From 2000-2004, federally-funded Acorn Housing Corporation (AHC) distributed \$369,376 to ACORN and its affiliates.¹³⁴

¹²⁶ *Fiscal Sponsorship Resources*, NAT'L COUNCIL OF NONPROFITS, <http://www.councilofnonprofits.org/fiscal-sponsorship-resources> (last visited May 7, 2013).

¹²⁷ *About Fiscal Sponsor Directory*, FISCAL SPONSOR DIRECTORY, http://www.fiscalsponsordirectory.org/about_us.php (last visited May 7, 2013).

¹²⁸ *Hearing on Operations and Oversight of Tax-Exempt Organizations Before the H. Comm. on Ways and Means*, 112th CONG. 2 (2012) (statement of Mary Beth Hutchins, Commc'ns Dir., Cause of Action, available at http://waysandmeans.house.gov/uploadedfiles/cause_of_action_051612os.pdf).

¹²⁹ See *infra* notes 133, 154, 162.

¹³⁰ Claire Suddath, *A Brief History of ACORN*, TIME, Oct. 14, 2008, available at <http://www.time.com/time/politics/article/0,8599,1849867,00.html>.

¹³¹ *Id.*

¹³² Carl Hulse, *House Prohibits Federal Money to Acorn*, N.Y. TIMES, Sept. 17, 2009, available at http://www.nytimes.com/2009/09/18/us/18acorn.html?_r=0.

¹³³ STAFF OF H. COMM. ON OVERSIGHT & GOV'T REFORM, 111TH CONG., FOLLOW THE MONEY: ACORN, SEIU, AND THEIR POLITICAL ALLIES (2010), available at <http://oversight.house.gov/wp-content/uploads/2012/02/20100218followthemoneyacornseiuandtheirpoliticalallies.pdf>.

- In the same time period, AHC distributed a net total of \$2,422,855 (16.02% of its unrestricted revenue) to ACORN's fiscal sponsor, the American Institute for Social Justice (AISJ).¹³⁵
- 56.4% of the total amount of grants given out by AHC between 2000 and 2004 was disbursed to ACORN's fiscal sponsor, AISJ.¹³⁶
- From 2000-2004, AISJ distributed \$14,299,061 (75.94% of its unrestricted revenue) to ACORN.¹³⁷
- 95.9% of the total amount of grants given out by AISJ, from 2000-2004, were given to ACORN.¹³⁸
- \$53,209,025 in funds were transferred between ACORN and AISJ from 2000-2004.¹³⁹
- From 1999-2003, federally-funded Project Vote dispersed \$1,061,389 to ACORN.¹⁴⁰
- From 1999-2004, ACORN received a net total of \$15,729,826 from just three of its 501(c)(3) fiscal sponsors.¹⁴¹

¹³⁴ *Id.* at 13 n.17.

¹³⁵ *Id.* at 16-18.

¹³⁶ *Id.* at 19.

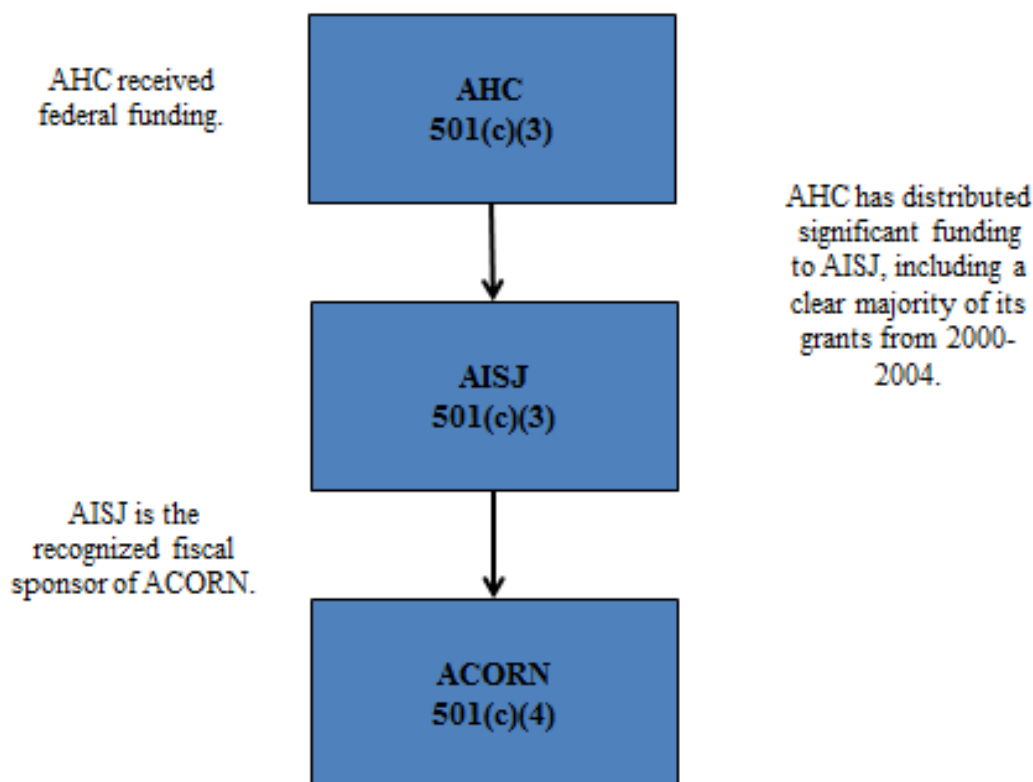
¹³⁷ *Id.* at 16-18.

¹³⁸ *Id.* at 18.

¹³⁹ FOLLOW THE MONEY, *supra* note 133, at 18.

¹⁴⁰ *Id.* at 17.

¹⁴¹ *Id.*



An Oversight Committee report affirmed that “ACORN engages in a shell-game of corporate financing, in which money is transferred from affiliate organizations receiving federal money to a national ACORN organization that engages in partisan political activities.”¹⁴² ACORN’s audit records revealed that ACORN’s 501(c)(3) affiliates acted as a “fiscal agent for other organizations” that “[f]or certain gifts and grants . . . receives the funds and then remits the amount received to the designated organization.”¹⁴³ Audits from AISJ confirm that each and every year from 1999 to 2004, AISJ “served as a fiscal agent” for ACORN.¹⁴⁴

In a November 2009 report from the U.S. Department of Justice (DOJ) Office of Inspector General (OIG), entitled “Review of Department of Justice Grants to the Association of Community Organizations for Reform Now, Inc. (ACORN) and its Affiliated Organizations,” the OIG found that “AISJ’s IRS Form 990 in 2002, the year AISJ received DOJ grant funds, showed that it had gross income of \$2.529 million and provided ACORN with \$1.684 million in grants, 67 percent of AISJ’s gross income.”¹⁴⁵ In 2006, “AISJ provided \$4.95 million, 56 percent of its \$8.84 million gross revenue, in grants to ACORN, and in 2007 \$165,644 in

¹⁴² *Id.* at 12.

¹⁴³ Audit Reports of Am. Inst. for Social Justice 2000-2004 (on file with author).

¹⁴⁴ *Id.*

¹⁴⁵ DEP’T. OF JUSTICE OFFICE OF INSPECTOR GENERAL, REVIEW OF DEPARTMENT OF JUSTICE GRANTS TO THE ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW, INC. (ACORN) AND ITS AFFILIATED ORGANIZATIONS at 19 (2009), available at <http://www.justice.gov/oig/special/s0911.pdf>.

contractual payments to ACORN.”¹⁴⁶ With over half of AISJ’s annual income regularly being funneled to finance ACORN’s political activity, serious questions arise regarding the propriety of such organizations receiving any federal money. All fiscal sponsorship arrangements should be considered before federal funding is doled out.

ACORN’s most obvious association is with ACORN Institute, a 501(c)(3) organization with several related missions to ACORN, including “research and public policy development on issues of economic and social justice.”¹⁴⁷ ACORN Institute’s 2005 audit states that “ACORN Institute, Inc. served as a fiscal agent for the . . . Association of Community Organizations for Reform Now.”¹⁴⁸ The DOJ OIG report claimed that in 2006, “the ACORN Institute provided approximately \$2.1 million of its \$3.56 million gross income (59 percent) to ACORN and ACORN Services, Inc., in the form of grants and contracts” and in 2007 “the ACORN Institute gave 41 percent, approximately \$1.15 million, of its \$2.8 million gross income to ACORN and ACORN Services, Inc., as grants and payments for contract services.”¹⁴⁹

The DOJ OIG also found New York Agency for Community Affairs (NYACA) “[is] an affiliate of ACORN because it acted as a fiscal agent for ACORN.”¹⁵⁰ According to the report, “[I]n 2007 NYACA provided 97 percent of its \$730,334 gross income to ACORN for ‘contractual services.’ NYACA’s 2005-2006 financial statement stated that NYACA acts as a fiscal agent for ACORN by remitting to ACORN certain gifts and grants that NYACA receives.”¹⁵¹ The DOJ OIG noted that “NYACA was also listed as the fiscal agent for ACORN on a sub-award agreement between the Citizens Committee for New York City, Inc. and ACORN.”¹⁵² However, according to the DOJ OIG, “DOJ did not conduct any audits, financial reviews, or site visits of the five grants that were awarded to ACORN or its affiliates, either directly or as a sub-award recipient.”¹⁵³

In 2005, there were over a thousand transactions, amounting to nearly \$12 million, between ACORN and its tax-exempt affiliates.¹⁵⁴ With almost three money transfers per day, proper oversight of ACORN’s financial activities and internal controls on separations between nonprofit and non-exempt affiliates would seem to be nearly impossible to enforce. Accordingly, in 2008, Beth Kingsley of the Washington, D.C. law firm Harmon, Curran, Spielberg & Eisenberg prepared an internal report for ACORN and eleven separate 501(c)(3) ACORN affiliates to “conduct a review of the operations and inter-relationships” and the “legally appropriate ways of structuring their relationships.”¹⁵⁵ The Kingsley report stated that

¹⁴⁶ *Id.*

¹⁴⁷ ACORN Institute, Inc. 2009 Form 990 (on file with author).

¹⁴⁸ ACORN INSTITUTE, INC. NOTES TO FINANCIAL STATEMENTS 2005 (on file with author).

¹⁴⁹ DEP’T OF JUSTICE OFFICE OF INSPECTOR GENERAL, *supra* note 146, at 14.

¹⁵⁰ *Id.* at 2.

¹⁵¹ *Id.* at 11.

¹⁵² *Id.* at 11 n.19.

¹⁵³ *Id.* at 23.

¹⁵⁴ STAFF OF H. COMM. ON OVERSIGHT & GOV’T REFORM, 111TH CONG., IS ACORN INTENTIONALLY STRUCTURED AS A CRIMINAL ENTERPRISE? 50 (2009) [hereinafter CRIMINAL ENTERPRISE].

¹⁵⁵ Memorandum from Harmon, Curran, Spielberg & Eisenberg, LLP, to ACORN Beneficial Ass’n, ACORN Housing Corp., ACORN Inst., ACORN Votes, Am. Inst. for Social Justice, Ass’n of Cmty. Orgs. for Reform Now, Citizens Consulting, Inc., Cmty. Voting Together, Pa. Inst. for Cmty. Affairs, Inc., Project Vote/Voting for Am., Inc. (June 19, 2008) [hereinafter Kingsley Report] at 1, available at <http://www.breitbart.com/Big->

because ACORN's 501(c)(3) affiliates failed to exercise proper oversight over ACORN's activities, ACORN was "an organization that has to be prepared to be scrutinized by a hostile investigator."¹⁵⁶ Kingsley detailed the problems that such a "hostile investigator" would recognize. ACORN had legal control over one of its most prominent fiscal sponsors, Project Vote, which "has on paper a procedure to select regions where it will do voter registration, but [we] have heard reports in the past that in practice those decisions may be communicated to [Project Vote] from ACORN . . . [Project Vote] needs to really be in charge of deciding where 501(c)(3) resources will be focused . . . And the [Executive Director] must not be wearing other 'hats' that jeopardize her ability to act solely in the interest of these 501(c)(3)s."¹⁵⁷

There are several other such assessments of ACORN's activities: Curtis Crider, Inspector General of the Election Assistance Commission, stated that for a federal grant provided to Project Vote, "ACORN performed the service, not Project Vote . . . There was no written agreement between ACORN and Project Vote. There should have been a formal agreement."¹⁵⁸ Kingsley also found that ACORN lacked "an adequately documented delineation of 501(c)(3) from non-501(c)(3) work" and charged that ACORN "cannot confirm that strategic decisions about which regions do 501(c)(3) versus non-501(c)(3) voter engagement work are not being made by the same person or people . . . **we may not be able to prove that 501(c)(3) resources are not being directed to specific regions based on impermissible partisan considerations.**"¹⁵⁹ Kingsley faulted ACORN again for its management of Communities Voting Together, a § 527 organization, which is "treated like a pot of money available to ACORN to carry out state-level political work."¹⁶⁰

B. ACORN-Like Abuse by Rebranded ACORN Organizations and Affiliates

In 2010, ACORN's national organization filed for Chapter 7 bankruptcy and largely disbanded.¹⁶¹ Former affiliates and chapters of ACORN, however, continued to function under different names, in some cases while retaining their same tax identification numbers, employees, and office space.¹⁶² Cause of Action has investigated several of these rebranded ACORN organizations and affiliates for potentially using fiscal sponsorship improperly as a way to channel government funds to prohibited recipients. Our investigation found patterns of behavior that mirror ACORN's past abuse of the tax code. In several of the largest former ACORN affiliates (the New York, California, and Texas chapters of ACORN), conduit funding, exempt donations used for political activity, and unreported lobbying characteristic of the corrupt fiscal

Government/2009/10/01/EXCLUSIVE--ACORN-Legal-Memo-Confirms-Depths-of-Troubles (citing CRIMINAL ENTERPRISE, *supra* note 154, at 12 n.53).

¹⁵⁶ Memorandum from Harmon, Curran, Spielberg & Eisenberg, LLP et al., *supra* note 155, at 12-13.

¹⁵⁷ *Id.*

¹⁵⁸ Interview of Curtis Crider, Inspector Gen., U.S. Election Assistance Comm'n (May 24, 2010).

¹⁵⁹ Memorandum from Harmon, Curran, Spielberg & Eisenberg, LLP et al., *supra* note 155, at 7.

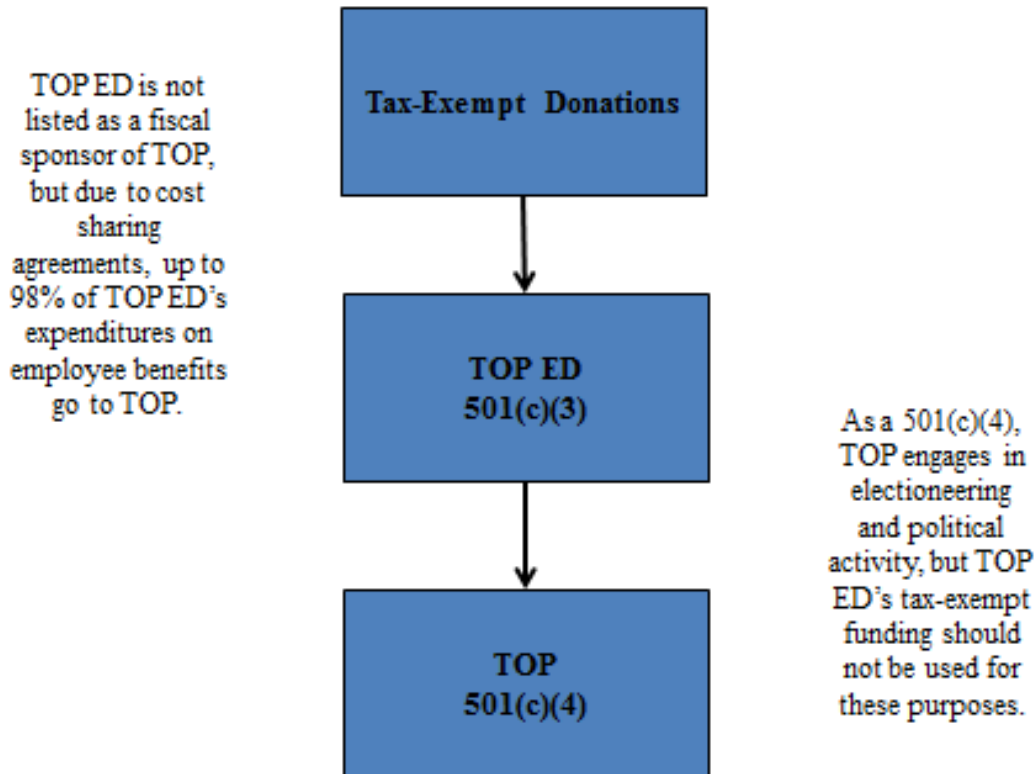
¹⁶⁰ *Id.* at 8. 527 organizations are created primarily to influence the selection, nomination, election, appointment or defeat of candidates to federal, state or local public office. 26 U.S.C. § 527.

¹⁶¹ Matthew Vadum, *ACORN Files for Chapter 7 Bankruptcy – And Blames (or Credits?) 'Right-Wing Media' for Downfall*, DAILY CALLER (Nov. 2, 2010), <http://dailycaller.com/2010/11/02/acorn-files-for-chapter-7-bankruptcy-%E2%80%94-and-blames-or-credits-right-wing-media-for-downfall/>.

¹⁶² MINORITY STAFF OF H. COMM. ON OVERSIGHT & GOV'T REFORM, 111TH CONG., *ACORN Political Machine Tries to Reinvent Itself* (2010), available at: <http://oversight.house.gov/wpcontent/uploads/2012/02/20100401ACORNreport.pdf>.

sponsorship schemes which ACORN organizations previously instituted reappear without amelioration.

1. Texas Organizing Project & Texas Organizing Project Education Fund



The Texas Organizing Project (TOP), formed from the Texas chapters of ACORN,¹⁶³ is a 501(c)(4) organization that “promotes social and economic equality for low to moderate income Texans through community and electoral organizing.”¹⁶⁴ The Texas Organizing Project Education Fund (TOP ED), however, is a 501(c)(3) organization that is virtually indistinguishable from TOP and which holds goals identical to it, but purports to achieve them by “building power through community organizing and civic engagement.”¹⁶⁵ As a 501(c)(4) organization,¹⁶⁶ TOP may engage in electioneering activities,¹⁶⁷ but TOP ED, a 501(c)(3)

¹⁶³ Matthew Vadum, *Rebranding Hoax Continues*, NEWS REAL BLOG (Mar. 30, 2010), <http://www.newsrealblog.com/2010/03/30/texas-comes-aboard-the-acorn-rebranding-hoax-continues/>; see also Matthew Vadum, *ACORN Official: Gangster Group Will Be Bankrupt Soon But Fake Spinoff Groups Will Carry On the Corruption*, BREITBART.COM (Feb. 24, 2010), <http://www.breitbart.com/Big-Government/2010/02/24/ACORN-Official--Gangster-Group-Will-Be-Bankrupt-Soon-But-Fake-Spinoff-Groups-Will-Carry-On-The-Corruption>.

¹⁶⁴ *Mission*, TEX. ORGANIZING PROJECT, <http://www.organizetexas.org/about/mission> (last visited May 7, 2013).

¹⁶⁵ See *Texas Organizing Project Education Fund*, GUIDESTAR, <http://www.guidestar.org/FinDocuments/2011/271/481/2011-271481855-08d61e72-9.pdf> (last visited May 9, 2013).

¹⁶⁶ See *id.*

¹⁶⁷ See INTERNAL REVENUE MANUAL § 7.25.4.6-7 (1999).

organization,¹⁶⁸ cannot fund or engage in electioneering activities without jeopardizing its ability to receive tax-deductible contributions.

On August 21, 2012, Cause of Action wrote to Douglas Shulman, the Commissioner of the IRS,¹⁶⁹ concerning potential conduit funding of TOP by its affiliate, TOP ED.¹⁷⁰ According to TOP and TOP ED's 2010 Form 990, TOP and TOP ED are engaged in a cost sharing agreement.¹⁷¹ Under that agreement, TOP ED paid TOP \$502,301 in exchange for TOP providing its employees to perform work for TOP ED.¹⁷² TOP ED spent \$512,105 in total that year on costs relating to benefits and salaries for employees.¹⁷³ The funds paid to TOP as part of the employee sharing program therefore represented 98.1% of TOP ED's total expenditures on employee salaries and benefits. The same year, TOP ED received \$839,046 in grants and contributions.¹⁷⁴ This means that TOP ED spent 61% of its funds—the clear majority—on employee salaries and benefits. While TOP ED reported no grants to TOP that year, and thus would not appear to be fiscally sponsoring TOP, the “cost sharing” agreement wherein TOP ED transferred the majority of its funds to TOP acts effectively as a fiscal sponsorship arrangement. TOP ED's 2011 Form 990 indicates that it is still engaged in this cost sharing agreement.¹⁷⁵

Texas Ethics Commission reports from 2010 to the present reveal tens of thousands of dollars being spent on salaries and benefits for TOP employees engaging in electioneering communications.¹⁷⁶ For example, TOP hired Crystal Zermeno to serve as Strategy Director, recruiting her from a position as Political Coordinator for the Service Employees International Union.¹⁷⁷ In Texas, TOP is registered as a General-Purpose Political Committee (GPPC), which according to the Texas Ethics Commission's Campaign Finance Guide is “[a] political committee that supports candidates who are members of a particular political party.”¹⁷⁸ In a one year period, TOP spent close to \$130,000 on electioneering activities for political candidates.¹⁷⁹

¹⁶⁸ See *Texas Organizing Project Education Fund*, *supra* note 165.

¹⁶⁹ Commissioner Shulman has resigned, effective November 9, 2012. Patrick Temple-West, *IRS Names Acting Commissioner, Shulman Steps Down*, REUTERS (Oct. 10, 2012, 6:23 PM EDT), <http://www.reuters.com/article/2012/10/10/us-usa-tax-commissioner-idUSBRE8991QE20121010>.

¹⁷⁰ See Letter from Cause of Action Staff, to Douglas Shulman, Comm'r, Internal Revenue Serv. (August 21, 2012).

¹⁷¹ See *Texas Organizing Project Education Fund*, GUIDESTAR, at 32,

<http://www.guidestar.org/FinDocuments/2010/271/481/2010-271481855-07c7a9b4-9.pdf> (last visited May 9, 2013).

¹⁷² *Id.* at 30.

¹⁷³ *Id.* at 1.

¹⁷⁴ *Id.*

¹⁷⁵ See *Texas Organizing Project Education Fund*, GUIDESTAR,

<http://www.guidestar.org/FinDocuments/2011/271/481/2011-271481855-08d61e72-9.pdf> (last visited June 10, 2013).

¹⁷⁶ See *Search Campaign Finance Reports*, TEX. ETHICS COMM'N, <http://www.ethics.state.tx.us/php/cesearchAdvanced.html> (last visited May 9, 2013) (search “Texas Organizing Project” in Entity Name from 1/1/2010 to 8/22/2012).

¹⁷⁷ *Crystal Zermeno*, LINKEDIN, <http://www.linkedin.com/pub/crystal-zermeno/23/918/95b> (last visited May 9, 2013).

¹⁷⁸ *Campaign Finance Guide for Political Committees*, TEX. ETHICS COMM'N,

http://www.ethics.state.tx.us/guides/PAC_guide.htm#PAC_GPAC (last visited May 9, 2013).

¹⁷⁹ From July 1, 2011 through September 29, 2011, TOP spent \$7,577 on electioneering activities. From September 30, 2011 through October 29, 2011, TOP spent \$44,610 on electioneering activities. From October 30, 2011 through November 30, 2011, TOP spent \$34,970 on electioneering activities. From December 1, 2011 through December 31, 2011, TOP spent \$22,805 on electioneering activities. From January 1, 2012 through May 2, 2012,

TOP has also conducted activities on behalf of specific candidates for elected office.¹⁸⁰ TOP received contributions from Texas electoral candidate Kristi Thibaut¹⁸¹ and the Texas Forward Committee, a political action committee (PAC).¹⁸² On February 16, 2010, Kristi Thibaut's campaign paid TOP \$2,500 and listed the expenditure's purpose as "Gifts/Awards/Memorials Expense."¹⁸³

1 PAGE # Schedule: 17/18 Report: 53/55		2 FILER NAME Thibaut, Kristi		3 ACCOUNT # (TEC filers) 00058217	
4 Date 02/16/2010		5 Payee name Texas Organizing Project			
6 Amount (\$) \$2,500.00		7 Payee address City; State; Zip Code 2506 Sutherland Houston, TX 77023			
8 PURPOSE OF EXPENDITURE		(a) Category (See Categories listed at the top of this schedule) Gift/Awards/Memorials Expense		(b) Description (If travel outside of Texas, complete Schedule T) <input type="checkbox"/> Contribution	
9 Complete ONLY if direct expenditure to benefit C/OH		Candidate / Officeholder name		Office sought: Office held:	

If TOP procured gifts or awards from a candidate (perhaps in exchange for services rendered), such an activity would not be an exempt purpose and TOP would be subject to unrelated business income tax (UBIT).

On April 6, 2010, the Texas Forward Committee paid TOP \$5,000 and listed the expenditure's purpose as "Contributions/Donations Made By Candidate/Officeholder/Political Committee."¹⁸⁴

Date 04/06/2010		Payee name Texas Organizing Project			
Amount (\$) \$5,000.00 <input type="checkbox"/> Expenditure from corporate funds		Payee address City; State; Zip Code 2506 Sutherland Houston, TX 77023			
PURPOSE OF EXPENDITURE		Category (See Categories listed at the top of this schedule) Contributions/Donations Made By Candidate/Officeholder/Political Committee		Description (If travel outside of Texas, complete Schedule T) <input type="checkbox"/> Donation	
Complete ONLY if direct expenditure to benefit C/OH		Candidate / Officeholder name		Office sought: Office held:	

TOP spent \$1,689 on electioneering activities. From May 3, 2012 through May 19, 2012, TOP spent \$6,341 on electioneering activities. From May 20, 2012 through June 30, 2012, TOP spent \$10,164 on electioneering activities. See Texas Ethics Commission Campaign Finance Report Search, available at <http://www.ethics.state.tx.us/php/cesearchAdvanced.html> (searchable by "TOP" and date of expenditure).

¹⁸⁰ Letter from Cause of Action Staff, to Douglas Shulman, *supra* note 170.

¹⁸¹ See *Candidate/Officeholder Campaign Finance Report for Kristi Thibaut*, TEX. ETHICS COMM'N, 53, <http://204.65.203.5/public/458165.pdf> (last visited May 9, 2013).

¹⁸² See *Candidate/Officeholder Campaign Finance Report for Texas Forward Committee*, TEX. ETHICS COMM'N, 7, <http://204.65.203.5/public/458388.pdf> (last visited May 9, 2013).

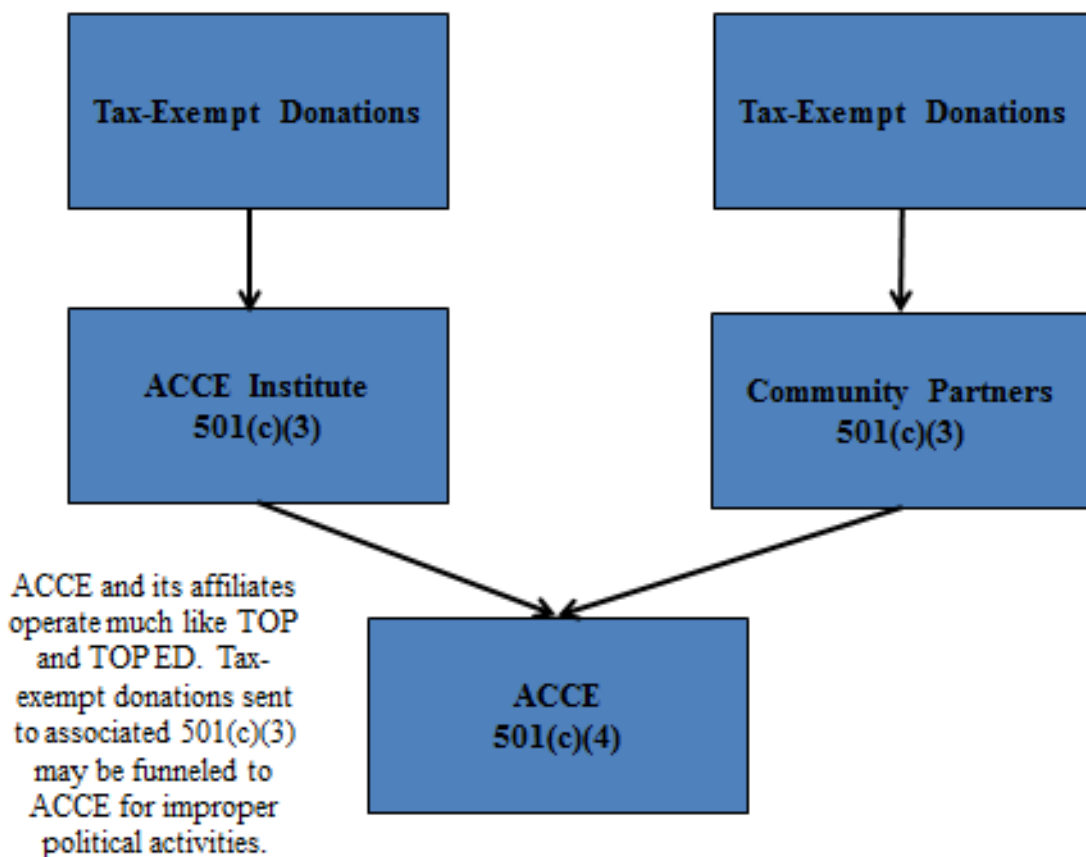
¹⁸³ *Thibaut*, *supra* note 181.

¹⁸⁴ See *Campaign Finance Report for Texas Forward Committee*, *supra* note 182.

PACs can make expenditures to nonprofits, but it is unclear whether TOP used the Texas Forward Committee donation for a 501(c)-compliant event or if TOP provided some benefit to the PAC.

TOP itself may warrant an IRS investigation into whether it is paying the proper taxes for non-exempt activities under the Federal Election Campaign Act. Furthermore, any potential inappropriate political activity of a 501(c)(4) casts doubt on 501(c)(3)s associated with it: because TOP ED effectively fiscally sponsors TOP, it too may warrant investigation. TOP engages in partisan, political, and electioneering activity, yet TOP ED, a 501(c)(3) organization, spends essentially all of its tax-exempt donations (98.1% in 2010) on a politically-involved organization without even declaring its sponsorship of that organization. It is thus very possible that tax-exempt donations were used by these organizations for partisan, political activity.

2. Alliance of Californians for Community Empowerment



ACCE is a 501(c)(4) organization whose mission focuses on “building power in low to moderate income neighborhoods to stand and fight for social, economic, and racial justice.”¹⁸⁵ ACCE has spent its funds heavily on political purposes. Currently, ACCE’s website displays its

¹⁸⁵ *About*, ALLIANCE OF CALIFORNIANS FOR COMMUNITY EMPOWERMENT, www.calorganize.org/about (last visited May 9, 2013).

preference for candidate Ami Bera over Congressman Dan Lungren in the race for California's 7th Congressional district,¹⁸⁶ while in early 2012 ACCE announced it was searching for a "Community/Political Organizer" to "[develop] relationships with key political players and opinion leaders."¹⁸⁷ The Facebook page for ACCE is filled with posts in support of Proposition 30 and against Proposition 32: Proposition 30 was a combination of several proposed tax increases¹⁸⁸ and Proposition 32 would have banned unions from using payroll deductions for political ends.¹⁸⁹ ACCE's exhortation on November 5, 2012, the day before the election, to "vote YES ON 30 and NO ON 32" displays a clear partiality towards certain legislation.¹⁹⁰ Moreover, ACCE is a member of Catalist, a data collection organization which helped elected President Obama in 2008. According to the 2009 Catalist report on member activities, "Obama did better where more progressive registration and persuasion work occurred."¹⁹¹ This is the same type of work that ACCE performs in all its regular operations, in addition to its participation in Catalist's work. ACCE's 501(c)(4) status does not restrict it from these overtly political activities; however, its 501(c)(3) affiliates, which are tax-exempt, are severely limited in their ability to associate themselves with political entities.

Though ACCE's political practices may be legal with its 501(c)(4) classification, its compliance with regulations regarding lobbying activities has been inadequate. On September 16, 2011, the Fair Political Practices Commission (FPPC), a body tasked with enforcing the provisions of California's Political Reform Act, issued a warning letter to ACCE after finding that ACCE had violated the Political Reform Act's lobbying reporting provisions.¹⁹² The warning letter describes how ACCE failed to timely report lobbying activities between October 1, 2010 and December 31, 2010—the time period surrounding the highly charged 2010 midterm elections.¹⁹³ Although ACCE belatedly reported that it had not lobbied during this time period, the extensive political activities conducted by ACCE and the suspect timing of its failure to report to the FPPC suggest that further inquiries should be made into the accuracy of this report and the legality of ACCE's finances.

The primary legal problem with ACCE's activities, however, is the fiscal sponsorship it has established with 501(c)(3) organizations. Cause of Action is concerned that ACCE may actually have legal control over its affiliated 501(c)(3) entities. On February 27, 2012, we wrote

¹⁸⁶ Sbrooks, *99% Voters Endorse Bera in Redrawn Congressional District*, ALLIANCE OF CALIFORNIANS FOR COMMUNITY EMPOWERMENT (Sept. 27, 2012, 4:32 PM), <http://www.calorganize.org/node/1086>; Dlagstein, *99 Percent Movement Targets Congressman Lungren*, ALLIANCE OF CALIFORNIANS FOR COMMUNITY EMPOWERMENT (May 29, 2012, 4:16 PM), <http://www.calorganize.org/node/916>.

¹⁸⁷ Alliance of Californians for Cmty. Empowerment, Job Description, Community/Political Organizer, (Posted Apr. 5, 2012) (on file with author).

¹⁸⁸ *Prop 30: Temporary Taxes to Fund Education*, CAL. SECRETARY OF STATE, <http://voterguide.sos.ca.gov/> (last visited May 24, 2013).

¹⁸⁹ *Prop 32: Political Contributions by Payroll Deduction*, CAL. SECRETARY OF STATE, <http://voterguide.sos.ca.gov/> (last visited May 24, 2013).

¹⁹⁰ *Alliance of Californians for Community Empowerment*, FACEBOOK, <https://www.facebook.com/CalOrganize?fref=ts> (last visited May 24, 2013).

¹⁹¹ CATALIST, AGGREGATE ACTIVITIES OF PROGRESSIVE ORGANIZATIONS IN 2008: COMPILATION OF DATA FROM CATALIST SUBSCRIBERS (2009).

¹⁹² Letter from Gary Winuk, Chief, Enforcement Div., Fair Political Practices Comm'n, to Marina Delgado, Exec. Dir., Alliance for Californians for Cmty. Empowerment (Sept. 16, 2011), *available at* http://www.fppc.ca.gov/enf_letter/09-26-11/ENF021.pdf.

¹⁹³ *Id.*

to the IRS requesting an investigation into ACCE, and wrote again on April 2, 2012 reporting that ACCE might be using its 501(c)(3) tax-exempt affiliate the ACCE Institute as a conduit for receiving tax-deductible contributions for improper political and electioneering activities.

As discussed above, as a 501(c)(4) organization,¹⁹⁴ ACCE has leeway to engage in political activities, but its 501(c)(3) affiliate, the ACCE Institute, does not. The relationship between these two organizations is intricate: for example, ACCE and the ACCE Institute share a mailing address, indicating that their staffs may considerably overlap.¹⁹⁵ ACCE's extensively documented political activity in concert with its intimate relationship with the ACCE Institute suggests that ACCE may actually have legal control over its 501(c)(3) entities and might be using them as a tax-deductible funnel to fund ACCE's political and electioneering activities. One such group, Community Partners, gave ACCE \$447,495 of the \$712,938 total grant funds it awarded in 2010, a total of 63% of grant expenditures.¹⁹⁶ The funds granted to ACCE were purportedly for "California Alliance Summer 2010 Voter Engagement Programs" and an "Education and Training Program."¹⁹⁷ Under the IRC, a 501(c)(3) organization may not direct a "substantial part" of its funds to lobbying and political activities; consequently, Community Partners' reported taxes should be audited or investigated, as the two-thirds of its 2010 budget donated to ACCE certainly constitutes a "substantial" part.¹⁹⁸ Moreover, it is not legal for a 501(c)(3) organization to give any money to an organization that engages in political activity. The relationship between these two organizations merits serious investigation into possible fraudulent financial activity.

In sum, Community Partners and the ACCE Institute groups may be improperly sponsoring ACCE and its political activities in violation of the IRC. ACCE might be conducting electioneering activities with funds generated from tax-deductible contributions to 501(c)(3) organizations, which could have tax consequences for both ACCE and its affiliates. These activities are inconsistent with the IRC and may warrant revocation of ACCE Institute's and Community Partners' tax-exempt status. For these reasons, and in light of ACCE's failure to comply with California's Political Reform Act, further investigation of ACCE and its relationships with the ACCE Institute and Community Partners is needed.

¹⁹⁴ See *Alliance of Californians for Community Empowerment*, GUIDESTAR, 1, <http://www.guidestar.org/FinDocuments/2010/271/482/2010-271482731-07713268-90.pdf> (last visited May 9, 2013).

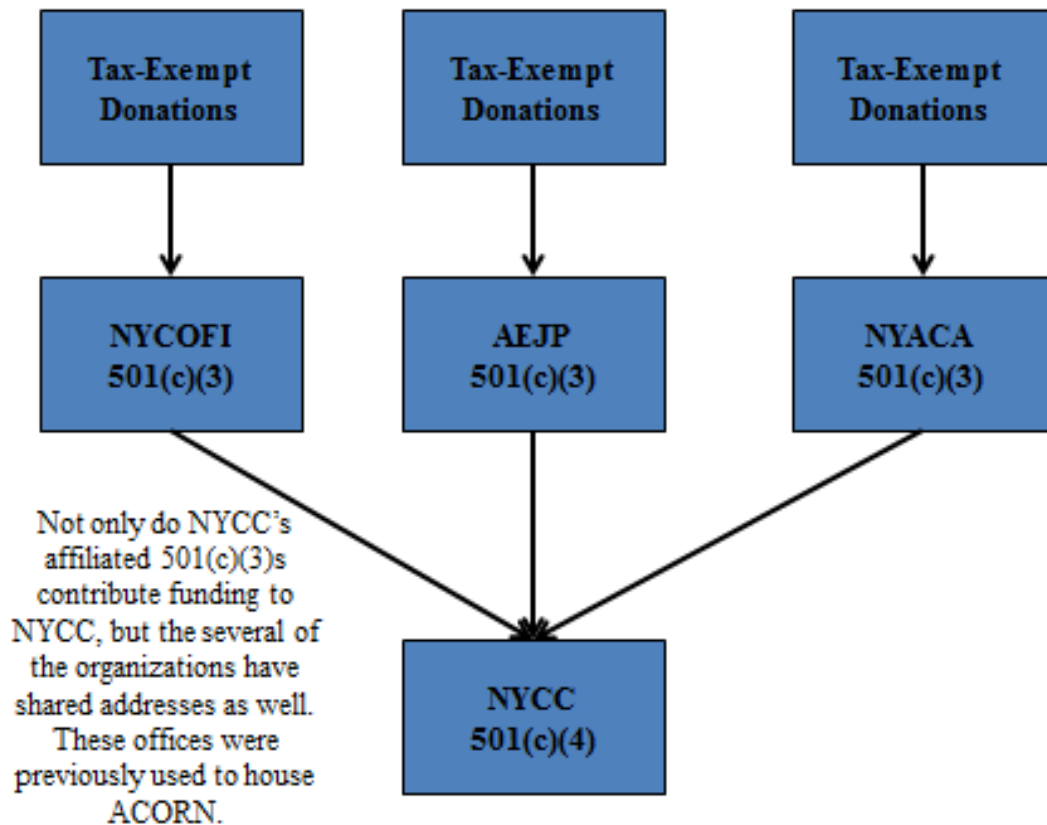
¹⁹⁵ *Id.*; see also *ACCE Institute*, GUIDESTAR, 1, <http://www.guidestar.org/FinDocuments/2011/271/487/2011-271487442-087afb03-9.pdf> (last visited May 24, 2013).

¹⁹⁶ See Letter from Daniel Epstein, Exec. Dir., Cause of Action, to J. Russell George, Treasury Inspector Gen. for Tax Admin, Dep't of the Treasury (Feb. 27, 2012).

¹⁹⁷ *Id.*

¹⁹⁸ 26 U.S.C. § 501(c)(3).

3. New York Communities for Change



On November 7, 2011, Chairman Darrell Issa of the Oversight Committee sent the U.S. Attorney for the Eastern District of New York a letter outlining allegations of improper participation by New York Communities for Change (NYCC), a 501(c)(4) organization, in the Occupy Wall Street protests. In the letter, Issa detailed his concerns about NYCC's relationship with the former New York chapter of ACORN, noting that "NYCC's office is located in a space formerly held by ACORN, and NYCC employs many former ACORN staffers, including New York's former ACORN director."¹⁹⁹

Cause of Action wrote to the IRS on October 21, 2011, requesting an investigation into NYCC and detailing how ACORN used fiscal sponsorships in order to receive tax-exempt dollars for non-exempt activities.²⁰⁰ NYCC, like the former ACORN chapter of New York, may be engaged in improper fiscal sponsorship arrangements with the New York Communities

¹⁹⁹ Letter from Hon. Darrell Issa, Chairman, Comm. on Gov't Oversight & Reform, U.S. House of Representatives, to Hon. Loretta Lynch, U.S. Attorney, E. Dist. of New York (Nov. 7, 2011) [hereinafter Issa Letter] (citing Jana Winter, *Exclusive: ACORN Playing Behind Scenes Role in 'Occupy' Movement*, FOX NEWS (October 26, 2011), <http://www.foxnews.com/us/2011/10/26/exclusive-acorn-playing-behind-scenes-role-in-occupy-movement/>.)

²⁰⁰ Letter from Cause of Action Staff to Hon. Sarah Hall Ingram, Comm'r, Tax Exempt & Gov't Entities Div., Internal Revenue Serv. (Oct. 21, 2011).

Organizing Fund, Inc. (NYCOFI), the American Environmental Justice Project (AEJP), and NYACA, all 501(c)(3) tax-exempt organizations.

In its 2010-2011 Annual Report, NYCOFI described NYCC as its “sister organization”²⁰¹ and the two organizations shared space at 2-4 Nevins Street in Brooklyn, New York.²⁰² This is the same space formerly occupied by ACORN.²⁰³ Similarly, NYCC IRS filings note that it expected to receive \$9,500 from AEJP in 2010.²⁰⁴ According to AEJP’s 2008 Form 990 filed on August 28, 2009, AEJP’s offices are located on the same floor of the same building that once housed the ACORN Institute: 2609 Canal Street, 4th Floor, New Orleans, Louisiana.²⁰⁵ NYACA was also housed at 2609 Canal Street, 4th Floor, New Orleans, Louisiana in 2007, despite purportedly existing to serve New York. The connection to a former ACORN branch may be unsurprising as DOJ OIG found NYACA “to be an affiliate of ACORN because it acted as [its] fiscal agent.”²⁰⁶ Completing this circle of ACORN affiliates, NYACA moved its offices to New York in 2008 and now occupies the same space at 2-4 Nevins Street used by NYCOFI and NYCC and which was previously home to Brooklyn ACORN.²⁰⁷ According to NYCC documents, NYACA has entered into an agreement with NYCC to “carry out their complimentary purposes in an economical and efficient manner.”²⁰⁸

A further concern regarding NYACA is the fact that it might have received federal funds. NYACA is a related organization of the Mutual Housing Association of New York (MHANY), a 501(c)(3) tax-exempt organization based in Brooklyn, New York.²⁰⁹ In fact, the 990s of both organizations indicate that they reside at 2-4 Nevins Street.²¹⁰ MHANY owns numerous for-profit subsidiaries operating as public housing projects throughout New York. By its own admission, MHANY receives funds from the Department of Housing and Urban Development, Fannie Mae, and the Federal Home Loan Bank.²¹¹ Considering that NYACA is associated with MHANY, it is likely that NYACA, an organization abusing its tax-exempt status, also received federal funds.

²⁰¹ 2010-2011 Annual Report, N.Y. Communities Organizing Fund, Inc. (on file with author).

²⁰² *Id.*; see also *New York Communities for Change, Inc.*, GUIDESTAR, 1, <http://www.guidestar.org/FinDocuments/2011/271/359/2011-271359103-08fcf105-90.pdf> (last visited May 24, 2013).

²⁰³ See Issa Letter, *supra* note 199.

²⁰⁴ *Search Charities Database*, CHARITIESNYS.COM, http://www.charitiesnys.com/RegistrySearch/show_detail.s.jsp?id={3C609CC7-8A12-4AAA-9834-082B887AE317} (last visited May 9, 2013).

²⁰⁵ *Cf. American Environmental Justice Project, Inc.*, GUIDESTAR, <http://www.guidestar.org/FinDocuments/2008/721/364/2008-721364034-0556b38b-Z.pdf> (last visited May 10, 2013).

²⁰⁶ U.S. DEP’T OF JUSTICE, OFFICE OF INSPECTOR GEN., REVIEW OF DEPARTMENT OF JUSTICE GRANTS TO THE ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW, INC. (ACORN) AND ITS AFFILIATED ORGANIZATIONS (2009), available at <http://www.justice.gov/oig/special/s0911.pdf>.

²⁰⁷ ACORN, <http://web.archive.org/web/20100408202348/http://www.acorn.org/index.php?id=14541> (last visited May 24, 2013).

²⁰⁸ *Search Charities Database*, *supra* note 204.

²⁰⁹ *Mutual Housing Association of New York Inc.*, GUIDESTAR.ORG, <http://www.guidestar.org/FinDocuments/2012/112/848/2012-112848938-08b76a39-9.pdf> (last visited June 10, 2013) (listing NYACA as a related tax-exempt organization).

²¹⁰ *Id.*; *New York Agency for Community Affairs Inc.*, GUIDESTAR.ORG, <http://www.guidestar.org/FinDocuments/2009/721/367/2009-721367956-06ab88e7-9.pdf> (last visited June 10, 2013).

²¹¹ *Funders*, MHANY, <http://www.mutualhousingny.org/node/713> (last visited June 10, 2013).

The similarities between NYCOFI and NYCC, the financial relationship between AEJP and NYCC, and the above-described agreement between NYACA and NYCC all raise suspicions that NYCC is being improperly fiscally sponsored by one or more of these 501(c)(3) organizations. Conduit funding of NYCC by a 501(c)(3) organization would be alarming on its own, but would be especially concerning if NYCC had sought to influence the 2012 presidential election. On August 15, 2012, the *New York Times* described how NYCC's organizing director Jonathan Westin "design[ed] [an] anti-Romney campaign" with the objective of linking Governor Romney to defenders of Mayor Michael R. Bloomberg's education policies.²¹² This blatant electioneering activity would not only subject NYCC to taxation, but it would impute liability to any 501(c)(3) entity that acts as a sponsoring organization of NYCC's political activities.

Not only have NYCOFI, NYCC, and NYACA operated in a concerted political fashion, these organizations may have engaged in lobbying activities as well, but without reporting their involvement as required. An employee engages in lobbying if he or she makes more than one "lobbying contact," and spends at least 20 percent of his or her time for the employer on "lobbying activities" over a three-month reporting period.²¹³ Under the Lobbying Disclosure Act, (LDA) lobbying activities include direct "lobbying contacts and efforts in support of such contacts" such as preparation, planning, research, and other background work intended for use in such direct contacts.²¹⁴ A "lobbying contact" under the LDA is an "oral or written communication (including an electronic communication) to a covered executive branch official or a covered legislative branch official" which concerns the formulation, modification, or adoption of legislation, rules, regulations, policies, or programs of the federal government.²¹⁵ The term "lobbying activities" includes "lobbying contacts" as well as background activities and other efforts in support of such lobbying contacts.²¹⁶ The LDA requires the organization, rather than the individual employee or lobbyist, to register when the organization engages in covered "lobbying contacts" through its staff.²¹⁷ The organization must file its lobbying registrations and reports with the Office of the Secretary of the Senate and the Office of the Clerk of the House.²¹⁸

Jon Kest, the Executive Director of NYCC, is a registered lobbyist for NYCC in New York.²¹⁹ He also worked as a lobbyist for New York ACORN from 2005 to 2010.²²⁰ For several

²¹² Michael Grynbaum, *Coalition Aims to Link School Group and Romney*, N.Y. TIMES (Aug. 15, 2012), <http://www.nytimes.com/2012/08/16/nyregion/coalition-aims-to-link-romney-to-backers-of-bloombergs-education-agenda.html>.

²¹³ 2 U.S.C. § 1602(10) (2007).

²¹⁴ Lobbying Disclosure Act, 2 U.S.C. § 1602(7), P.L. 104-65, § 3(7) (1995).

²¹⁵ 2 U.S.C. § 1602(8) (1995), P.L. 104-65, § 3(8).

²¹⁶ 2 U.S.C. § 1602(7) (1995).

²¹⁷ 2 U.S.C. § 1603(a)(2) (1995).

²¹⁸ LOBBYING DISCLOSURE ACT, *available at* <http://lobbyingdisclosure.house.gov/index.html>.

²¹⁹ Letter from Jon Kest, Exec. Dir., NYCC, to the N.Y. State Comm'n on Public Integrity (Mar. 14, 2011), *available at* https://apps.jcope.ny.gov/lrr/Administration/UploadDocuments/Temp/A57_communitiesforchange-same-24591.tif.

²²⁰ Letter from Barbara Faherty, Assistant Treasurer of Ass'n of Cmty. Organizations for Reform Now, to the N.Y. Temporary State Comm'n of Lobbying (June 2, 2005), *available at* https://apps.jcope.ny.gov/lrr/Admin./UploadDocuments/Temp/L904_11084.tif; Letter from Patricia Boone, Member of the Bd. of Directors, NY ACORN, to N.Y. State Comm'n on Public Integrity (Apr..28, 2009), *available at*

years during that time period, New York ACORN was registered as a client under the LDA for lobbying activities associated with requests for federal grant funding.²²¹ The LDA states, “A person or entity whose employees act as lobbyists on its own behalf is both a client and an employer of such employees.”²²² Kest is an employee of NYCC and has lobbied on its behalf, yet NYCC is not registered with the LDA database.²²³

Moreover, NYCC and its 501(c)(3) affiliate NYCOFI recently hired the Advance Group to conduct a fundraiser honoring Senator Kirsten Gillibrand.²²⁴ NYCOFI has likely received federal funds given that its website claims “NYCOFI launched programs reaching thousands of New Yorkers, including the Volunteer Income Tax Assistance program that prepared 576 returns and helped families claim almost \$300,000 in Earned Income Tax Credits.”²²⁵ NYCOFI’s Executive Director Carlie Steen’s LinkedIn profile states that her responsibilities include “[e]ngaging in public education and advocacy for policy and administrative reforms.”²²⁶ Yet NYCOFI’s most recently disclosed Form 990 answered the question, “Did the organization engage in lobbying activities?” with “No.”²²⁷ Even a broad interpretation of the IRS provisions concerning lobbying would indicate that it is highly likely that NYCOFI has failed to report its lobbying activities.

The LDA was intended to reach “professional lobbyists” who are *compensated* to engage in lobbying activities on behalf of an employer or a client.²²⁸ Our investigation reveals that NYCC may have one or more compensated employees who engage in covered “lobbying.”²²⁹ If NYCC spends more than \$10,000 quarterly, it would be required to register under the LDA.²³⁰ Congress has both civil and criminal penalties for failing to comply with the LDA.²³¹ Given Kest’s position at NYCC, the potentially improper fiscal relationships between NYCC and

[https://apps.jcope.ny.gov/lrr/Admin./UploadDocuments/Temp/A34_assocforcommunityorganizations\(ny\)-\(same\)-18111.tif](https://apps.jcope.ny.gov/lrr/Admin./UploadDocuments/Temp/A34_assocforcommunityorganizations(ny)-(same)-18111.tif).

²²¹ QUERY THE LOBBYING DISCLOSURE DATABASE, *available at*

<http://soprweb.senate.gov/index.cfm?event=chooseFields> (hyperlink “Search Filings” type “ACORN” in “client name”).

²²² *Id.*

²²³ *NYC Lobbyist Search*, NYC.GOV, <http://www.nyc.gov/lobbyistsearch/search?lobbyist=Jon+Kest> (last visited May 31, 2013).

²²⁴ NYCC Invitation, *available at* <http://www.humanservicescouncil.org/documents/NYCC%20Invitation.pdf> (“For more information contact Jim at . . . Jim@theadvancegroup.com”) (Nov. 10, 2011).

²²⁵ N.Y. COMMUNITIES ORG. FUND, http://nycofi.nationbuilder.com/our_work (last visited October 23, 2012).

²²⁶ *Carlie Steen*, LINKEDIN.COM, <http://www.linkedin.com/pub/carlie-steen/3/53a/685> (last viewed Oct. 25, 2012).

²²⁷ N.Y. COMMUNITIES ORG. FUND, FORM 990 (2010), Part IV at 3, *available at*

<http://www.guidestar.org/FinDocuments/2010/272/332/2010-272332649-07c6984f-9.pdf>.

²²⁸ Jack Maskell, *Lobbying Regulations on Non-Profit Organizations*, CRS Report 96-809, May 7, 2008 at 7-10.

²²⁹ H. REP. 104-339, 104th Cong., 1st Sess. at 2 (1995).

²³⁰ 2 U.S.C § 1603(a)(3)(A)(i).

²³¹ “Whoever knowingly fails . . . to comply with any other provision of the Act, may be subject to a civil fine of not more than \$200,000, and whoever knowingly and corruptly fails to comply with any provision of this Act may be imprisoned for not more than 5 years or fined under title 18, United States Code, or both.” LOBBYING DISCLOSURE ACT GUIDE 2008, *available at*: http://lobbyingdisclosure.house.gov/amended_lda_guide.html.

various 501(c)(3) organizations with ties to ACORN, and Kest's status as a paid lobbyist,²³² an investigation into NYCC's compliance with the IRC would appear warranted.

As a result of suspicions that ACORN affiliates were abusing their tax-exempt status, Cause of Action submitted Form 13909 Tax-Exempt Organization complaints against various ACORN splinter groups, including the following: (1) TOP ED, for participating in a political campaign and for improperly fiscally sponsoring TOP;²³³ (2) NYCC, for its improper fiscal sponsorship relationships with NYCOFI, AEJP, and NYACA;²³⁴ and (3) Community Partners, for participating in a political campaign, excessive lobbying, and improper fiscal sponsorship of ACCE.²³⁵ Cause of Action even sought the assistance of the Treasury Inspector General for Tax Administration by requesting an investigation into ACCE.²³⁶ Apparently no enforcement action was ever taken against any of these entities in response to Cause of Action's concerns.²³⁷

VIII. Solutions to the Fiscal Sponsorship Problem

- **Finding:** Fiscal sponsorship lacks a formal definition. Congress must define fiscal sponsorship, much like it defined donor-advised funds in the Pension Protection Act of 2006 (PPA), in order to enable sponsors and projects to comply with the law. If the abuse of fiscal sponsorships is not addressed, groups such as ACORN will continue to manipulate the tax code and charitable projects such as those of IHC, HHH, and CCI will continue to be at risk for exploitation and fraud.
- **Finding:** The IRS should require fiscal sponsors to file all sponsorship agreements along with their Form 990s. The IRS should also limit fiscal sponsorships by time and gross receipts in order to decrease the risk of abuse. Finally, the IRS should terminate any fiscal sponsorship arrangement if the facts and circumstances reveal indicia, whether financial or otherwise, of independence from the sponsor sufficient to warrant separate corporate status.

²³² N.Y.C. Lobbyist Search, "Jon Kest", available at <http://www.nyc.gov/lobbyistsearch/search;jsessionid=QnHN631nwGSv8cmym4DwF4PT4cVBH5bQDrfncmmBr0sFvRcD2t!1834708824>.

²³³ 13909 Complaint against TOP ED from Cause of Action (June 6, 2012).

²³⁴ 13909 Complaint against NYCC from Cause of Action (June 28, 2012).

²³⁵ 13909 Complaint against Community Partners from Cause of Action (June 7, 2012).

²³⁶ Letter from Cause of Action to Hon. J. Russell George, Treasury Inspector General for Tax Admin., Dep't of the Treasury (Apr. 2, 2012).

²³⁷ See, e.g., IRS.GOV, <http://apps.irs.gov/app/eos/pub78Search.do?ein1=27-1481855&names=&city=&state=All...&country=US&deductibility=all&dispatchMethod=searchCharities&submitName=Search> (last visited June 10, 2013) (TOP ED); IRS.GOV, <http://apps.irs.gov/app/eos/pub78Search.do?ein1=27-1487442&names=&city=&state=All...&country=US&deductibility=all&dispatchMethod=searchCharities&submitName=Search> (last visited June 10, 2013) (ACCE); IRS.GOV, <http://apps.irs.gov/app/eos/pub78Search.do?ein1=52-1009973&names=&city=&state=All...&country=US&deductibility=all&dispatchMethod=searchCharities&submitName=Search> (last visited June 10, 2013) (AEJP); IRS.GOV, <http://apps.irs.gov/app/eos/pub78Search.do?ein1=27-2332649&names=&city=brooklyn&state=NY&country=US&deductibility=all&dispatchMethod=searchCharities&submitName=Search> (last visited June 10, 2013) (NYCOFI).

A. How Congress Defined Donor-Advised Funds, a Mechanism Similar to Fiscal Sponsorship, to Remove Ambiguities and Avoid Fraud

The problems that are associated with fiscal sponsorship are very similar to those of its cousin, the donor-advised fund. In the donor-advised fund arrangement, a charitable organization creates an account to which donors may contribute tax-exempt donations and provide nonbinding recommendations for the use of the funds in the future. Responding to perceived abuses in donor-advised funds, Congress passed the Pension Protection Act of 2006 (PPA), which imposed new restrictions on their operation and on contributions to them.²³⁸ Yet, despite clear similarities between fiscal sponsorships and donor-advised funds, Congress has neglected to take steps to respond to issues with the use of fiscal sponsorships.

1. What Are Donor-Advised Funds and How Are They Similar to Fiscal Sponsorships?

According to 26 U.S.C. § 4966(d)(2), a donor-advised fund is a fund “(i) which is separately identified by reference to contributions of a donor or donors, (ii) which is owned and controlled by a sponsoring organization, and (iii) with respect to which a donor . . . has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor’s status as a donor.”²³⁹ Donor-advised funds arise when charitable organizations establish accounts to which donors may contribute and thereafter provide “nonbinding advice or recommendations” with regard to distributions from the fund or the investment portfolio of the fund.²⁴⁰ Donors may take a charitable contribution deduction at the time of their contribution to these funds.²⁴¹

Donor-advised funds are distinguished from fiscal sponsorships in one important respect: donor-advised funds are typically donor driven.²⁴² More specifically, donor-advised funds are “driven by the interest of donors and usually public charities in avoiding the necessity for a separate legal entity, a private foundation, and instead having an understanding that donor advice will be given but the money will be held by the public charity subject to discretion and control.”²⁴³ Fiscal sponsorships, however, developed from “the bottom of the giving process, where projects, often grassroots community projects, are not yet organized as 501(c)(3) organizations. Instead of setting up a new nonprofit corporation and seeking tax-exempt status, the effort is made to essentially put the group or the individual under an existing 501(c)(3) public charity and receive the benefits of foundation gifts, donations, government grants, and so on that are only available to 501(c)(3) organizations.”²⁴⁴

²³⁸ In addition, while the PPA included a temporary provision that excluded from gross income certain distributions from Individual Retirement Arrangements (“IRAs”) directly to most charities, this special benefit was not provided for IRA distributions to donor-advised funds and private charitable foundations. See Sara Hansard, *Concerns May Foil a Tax Break Eyed by Donor-Advised Funds*, INVESTMENTNEWS (Oct. 22, 2007), <http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20071022/FREE/710220342>.

²³⁹ 26 U.S.C. § 4966(d)(2)(A)(i)-(iii).

²⁴⁰ 2006 TNT 207-13.

²⁴¹ I.R.S. Notice 2007-21, 2007-9 I.R.B. 611; *United States v. Am. Bar Endowment*, 477 U.S. 105 (1986).

²⁴² Colvin, *supra* note 6.

²⁴³ *Id.*

²⁴⁴ *Id.*

Nonetheless, many nonprofit experts have noted the similarities between fiscal sponsorships and donor-advised funds, especially concerning both of the arrangements' potential for abuse. For instance, Elizabeth Kingsley and Doug Smith, both nonprofit attorneys, have noted that some fiscal sponsorship arrangements are "closely related to donor-advised funds."²⁴⁵ Gregory Colvin notes that fiscal sponsorship can be "cousin to another three-party funding arrangement called the 'donor-advised fund.'"²⁴⁶ In fact, fiscal sponsorships and donor-advised funds are so similar that Colvin found it necessary to write a memorandum drawing distinctions between the two arrangements, out of concerns raised by many in the nonprofit community that some forms of fiscal sponsorship may fall under the definition of donor-advised funds set forth in the PPA.²⁴⁷ Fiscal sponsorships and donor-advised funds share many of the same benefits for charitable groups and individuals. Much as fiscal sponsorships allow individuals and groups to receive tax benefits without actually incorporating as a nonprofit, donor-advised funds have also been frequently used to allow donors to avoid the legal and administrative burdens of setting up a separate charitable foundation. Community foundations that support donor-advised funds take care of administration, legal due diligence, and tax paperwork while the donor "instructs where the money should go."²⁴⁸

Secondly, many of the IRS standards that apply to fiscal sponsorships also apply to donor-advised funds. For instance, similar to how fiscal sponsors must retain discretion and control over grants they receive on behalf of other organizations, sponsoring charities (known as "sponsor organizations") must also retain legal ownership and control over all donor-contributed assets.²⁴⁹ If a sponsoring organization lacks control or allows a donor to exercise control over contributions, the donor's contributions will not qualify for a charitable deduction.²⁵⁰

Most importantly, since both involve donations to 501(c)(3) organizations that are made indirectly instead of directly for the purposes of obtaining tax deductions, both fiscal sponsorships and donor-advised funds can be exploited by individuals or entities to receive tax benefits they are not entitled to receive. As stated earlier, fiscal sponsorships can be abused by non-exempt corporations to receive tax-deductible contributions that end up being used for non-exempt purposes, all while escaping IRS oversight.²⁵¹ Similarly, donor-advised funds have been abused by individual donors to receive tax deductions they should not receive. According to the Council on Foundations, "the integrity of donor-advised funds was called into question several

²⁴⁵ Beth Kingsley & Doug Smith, *Fiscal Sponsorships: Do it Right and Stay Out of Trouble*, NONPROFIT NAVIGATOR, May 2001, available at:

http://www.harmoncurrnan.com/?fuseaction=eUpdate.getArchives&newsletter_id=77#article2.

²⁴⁶ GREGORY L. COLVIN, FISCAL SPONSORSHIP IN THE 21ST CENTURY (2004), available at:

http://www.mtnonprofit.org/uploadedFiles/Files/Org-Dev/Principles_and_Practices/MNA_Sample_Docs/Fiscal-Sponsorships.pdf.

²⁴⁷ Memorandum from Greg Colvin to Concerned Fiscal Sponsors & Projects re: Is a Fiscal Sponsorship Account Maintained for a Project By A Public Charity Also a "Donor Advised Fund?" (Sept. 10, 2009), available at:

http://www.fiscalsponsorship.com/DAF%20definition%20for%20fiscal%20sponsor%20_00211211_.pdf.

²⁴⁸ Roy Furchgott, *Redirecting Heartache Into Donor Funds*, N.Y. TIMES (Nov. 12, 2007),

http://www.nytimes.com/2007/11/12/giving/12funds.html?_r=2&oref=slogin&pagewanted=print.

²⁴⁹ IRS Notice 2007-21, 2007-1 C.B. 611; *United States v. Am. Bar Endowment*, 477 U.S. 105 (1986).

²⁵⁰ IRS Notice 2007-21, 2007-1 C.B. 611; *United States v. Am. Bar Endowment*, 477 U.S. 105 (1986).

²⁵¹ Neal Cuthbert, McKnight Foundation, *Why We Don't Make Grants to Fiscal Agents*, 21 LEGALEASE at 2 (1997); See also SANDY DEJA, PREPARE YOUR OWN 501(C)(3) APPLICATION: HOW TO MAKE THE IRS LOVE YOUR FORM 1023, at 120-121 (2004).

years ago because regulators worried that **wealthy individuals could use donor-advised funds to control their assets - thereby abusing the tax system.**²⁵² As a Senate Committee on Finance aide once remarked, prior to the passage of the PPA, instead of giving money directly to a charity, individuals would gain tax deductions by placing money into a donor-advised fund where the money would sit while “fees [were] granted from it.”²⁵³ These concerns led the IRS to investigate donor-advised funds for their use as a tax loophole for private corporations.²⁵⁴ Concerns about the improper use of donor-advised funds also caused the IRS to place them on its “dirty dozen” list of tax scams for many years.²⁵⁵

Finally, fiscal sponsorships and donor-advised funds have also been proven to share the risk of becoming conduit arrangements. The risk is exemplified in the case of *New Dynamics Foundation v. United States*. There, the Court of Federal Claims rebuffed the request of an organization that provided donor-advised funds for recognition of 501(c)(3) status, reasoning that it was merely a conduit through which donors could build up personal wealth tax-free and siphon off the accumulated wealth for personal expenditures.²⁵⁶

2. The 2006 Pension Protection Act

In August 2006, Congress responded to concerns about the inappropriate use of donor-advised funds by passing the PPA. In this legislation, Congress formally defined the concept of a “donor-advised fund” by statute for the first time. Specifically, section 4966(d)(2)(A) of the IRS provides that a donor-advised fund is a fund or account with the following three qualities:

- “[S]eparately identified by reference to contributions of a donor or donors,”²⁵⁷
- “[O]wned and controlled by a sponsoring organization,”²⁵⁸ and
- “[W]ith respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor’s status as a donor.”²⁵⁹

According to the Congress Joint Committee on Taxation report on the PPA, a fund “that pools contributions of multiple donors” generally will not meet the first prong of the donor-

²⁵² *Donor-Advised Funds Removed from IRS Dirty Dozen List*, SOLANO COMMUNITY FOUND. (Oct. 22, 2007), http://www.solanocf.org/uploads/pdf/Donor_Advised_Removed_IRS.pdf (emphasis added).

²⁵³ Sara Hansard, *Concerns May Foil a Tax Break Eyed by Donor-Advised Funds; IRS Sees Problems at Smaller Organizations that Sponsor the Entities*, INVESTMENT NEWS (Oct. 22, 2007), www.investmentnews.com (subscription required).

²⁵⁴ Foundation Center, *IRS and Congress Scrutinize Donor-Advised Funds as Rollover Deadline Approaches*, PHILANTHROPY NEWS DIG. (Oct. 25, 2007), <http://foundationcenter.org/pnd/news/story.jhtml?id=192800075>.

²⁵⁵ *Donor-Advised Funds Removed from IRS Dirty Dozen List*, *supra* note 252.

²⁵⁶ *New Dynamics Found. v. United States*, 70 Fed. Cl. 782 (2006).

²⁵⁷ 26 U.S.C. § 4966(d)(2)(A)(i).

²⁵⁸ *Id.* § 4966(d)(2)(A)(ii).

²⁵⁹ *Id.* § 4966(d)(2)(A)(iii).

advised fund test if there is no tracking of a separate donor balance for each specific donor or group of related donors.²⁶⁰

Although the formal definition of a donor-advised fund may seem like a minor provision of the PPA, it was very important for attorneys advising nonprofit organizations. According to Allen Bromberger, an attorney with over 20 years of experience representing nonprofit organizations,²⁶¹ the statutory definition of what constituted a donor-advised fund was very helpful when advising clients on how to use these funds properly.²⁶² Bromberger also noted that having a formal definition of fiscal sponsorship would help simplify the process of advising clients on the proper use of these arrangements, as confusion on what constitutes fiscal sponsorship has contributed to many errors in its usage.²⁶³

In addition to defining a donor-advised fund, the PPA included special rules regarding the operation of such funds. For example, the PPA provides that certain transactions (specifically, grants, loans, compensation, and other similar payments) between a donor-advised fund and someone who is a donor, donor advisor or a person related to a donor or donor advisor will be treated as an excess benefit transaction and subject to excise tax under IRC section 4958. In addition, the provision imposes a tax on certain “taxable distributions” of donor advised funds, which includes, among other distributions: (1) distributions to natural persons, and (2) distributions to certain non-charitable organizations for charitable purposes, unless the donor-advised fund exercises expenditure responsibility with respect to the distribution.²⁶⁴ The provision also imposes a tax in certain situations where a donor, donor advisor, or someone related to a donor or donor advisor advises a distribution from a fund that results in a direct or indirect benefit to any such person.

Just as the definition of the arrangements would eliminate confusion on what constitutes fiscal sponsorship, the clarification of rules regarding the operation of fiscal sponsorships, could prevent confusion amongst projects about the practice and how it can be legally arranged. After interviewing John Raymond, a former project director under HHH, Cause of Action discovered that “many nonprofits were unaware of the system [of fiscal sponsorship] and when approached about the arrangements, many believed it would be illegal.” Clarification of the proper practice would allow nonprofits and projects to more easily and safely organize.

Though Congress felt the need to define donor-advised funds in the PPA in order to prevent abuse, the federal government has made no effort to respond to the use of fiscal sponsorships. If the abuse of fiscal sponsorships is not addressed in similar ways that concerns related to donor-advised funds were addressed in the PPA, groups like ACORN will be able to continue to abuse the tax code for their own narrow benefit.

²⁶⁰ STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., TECHNICAL EXPLANATION OF H.R. 4, THE “PENSION PROTECTION ACT OF 2006,” AS PASSED BY THE HOUSE ON JULY 28, 2006, AND AS CONSIDERED BY THE SENATE ON AUGUST 3, 2006 (Aug. 3, 2006).

²⁶¹ *Allen Bromberger*, PERLMAN & PERLMAN, http://www.perlmanandperlman.com/attorneys/allen_bromberger.shtml (last visited May 31, 2013).

²⁶² Interview with Allen Bromberger (Apr. 16, 2010) (on file with author).

²⁶³ *Id.*

²⁶⁴ 26 U.S.C. § 4966.

B. All Organizations that Engage in Fiscal Sponsorships Must File with Their Form 990 Copies of All Actual Sponsorship Agreements.

Fiscal sponsorship agreements should be contracts that identify the fiscal sponsorship arrangement between sponsor and client, as well as provide evidence that the sponsoring organization will exercise discretion and control over its client. Any 501(c)(3) organization that engages in fiscal sponsorship arrangements should be required to file with Form 990 copies of all of its written fiscal sponsorship arrangements. This will provide the IRS with confidence that the fiscally sponsored projects will be held accountable.

Allen Bromberger has found it problematic that the new Form 990 issued by the IRS does not ask the organization whether it has any fiscal sponsorship arrangements.²⁶⁵ Bromberger is currently engaged by ACORN to help disentangle its proper and improper activities as well as counsel ACORN in preparation for any regulatory review and scrutiny by law enforcement.²⁶⁶ CCI was largely able to defraud its projects due to the lax requirements of the Form 990. Were fiscal sponsorships included on Form 990s, CCI would have been required to recognize its projects legally. Clapp claimed after CCI's collapse that instead of traditional fiscal sponsorship, CCI and the Religious Institute had a "partnership." A formal definition of fiscal sponsorship, recognized on publicly available Form 990s, would prevent this type of fraud from being so easily perpetrated by fiscal sponsors.

Bromberger was quoted in *City Hall News* regarding the Working Families Party, an ACORN affiliate that mirrors ACORN's fraudulent tax activities, stating "I've never seen this kind of a set-up before . . . In order to pass muster at IRS, as far as I'm concerned, all the accounting and the bookkeeping and the allocation of costs would have to be done in a very diligent manner. Even then I think it could still be problematic . . . **if they're not able to show some substantial non-political activity by the 501(c)4, I think they've got a pretty significant problem.**"²⁶⁷ Bromberger made these statements before he began representing ACORN, but his view that the Working Families Party was "from a legal point of view 'wrong'," applies to ACORN as well because both entities used fiscal sponsorships in an abusive manner.²⁶⁸ Bromberger suggested that the IRS provide better "guidelines that allow fiscal sponsorship to be used where appropriate" and to allow for greater "transparency" in the guidance process.²⁶⁹ Bromberger asserted that "in the event that fiscal sponsorship is used, an arrangement plus a copy of the agreement between the entities should be in place and have to be disclosed to the agency."²⁷⁰ We agree. Not only would this prevent much of the corruption and subversion of fiscal sponsorship seen in ACORN affiliates, this practice would prevent abuse by fiscal sponsors such as HIH. Lane-Baker, CEO of HIH, was able to temporarily disarm her projects by constantly changing her requirements for fiscal sponsorship. HIH even made claims to a court that based on the fiscal sponsorship agreement, HIH could commandeer the funds and

²⁶⁵ Interview with Allen Bromberger, Perlman & Perlman LLP (2010) (on file with author).

²⁶⁶ *Id.*

²⁶⁷ *All In The Family Part I*, CITY & STATE(Nov. 30, 2009) <http://www.cityandstateny.com/all-in-the-family-part-1/>.

²⁶⁸ Interview with Allen Bromberger, Perlman & Perlman LLP (2010) (on file with author).

²⁶⁹ *Id.*

²⁷⁰ *Id.*

take control of a project itself.²⁷¹ Official agreements disclosed to a third party would prevent the type of fraud experienced by projects of HIH.

Failure to properly structure a fiscal sponsorship relationship in accordance with these new requirements, including failing to disclose projects on Form 990s, should merit suspension and debarment of grantees receiving federal funding. Because 501(c)(3) organizations engaging in fiscal sponsorship are privileged to tax-exemption and may receive federal funding, ensuring these organizations' compliance with the law is vital to protecting taxpayer interests. Those organizations which do conduct inappropriate conduit funding or funneling of tax-exempt dollars should be prevented from further misusing taxpayer dollars.

C. The IRS Must Limit the Sponsorship of Non-Exempt Projects by Both Time and Gross Receipts.

ACORN is a fiscally sponsored non-exempt corporation that has existed for 40 years and has over \$100 million in revenue.²⁷² While fiscal sponsorships make sense for “temporary” projects, the IRS has no set rules to define the appropriate time limit. Accordingly, the IRS must set guidelines that limit the amount of time a project can be fiscally sponsored, as otherwise there is a high risk that a sponsoring relationship collapses into money laundering. IHC and CCI were both fiscal sponsors for over a decade, while the Religious Institute was a project of CCI for ten years. Abiding by the original intent for fiscal sponsorship to be a temporary arrangement would decrease the risk of abuse by fiscal sponsors. Organizations which accrue large amounts of donations, which have the potential to be embezzled or mismanaged, have the resources and stability to receive their own 501(c)(3) status; organizations which are unable to sustain themselves and which do not have a temporary purpose should not qualify for endless tax-exempt donations. The successful projects of IHC and CCI lost the largest sums of money. These projects would be better protected if they had been required to apply for their own tax-exempt status after a temporary trial run under a fiscal sponsor.

Moreover, one purpose of fiscal sponsorship arrangements is to support the incubation of poorly funded organizations by better funded ones. However, the use of 501(c)(3)s to fiscally sponsor wealthy organizations like ACORN is inimical to this purpose. The IRS currently requires 501(c)(3) organizations with gross receipts greater than \$50,000 but less than \$200,000 to file Form 990-EZ²⁷³ whereas organizations with gross receipts equal to or below \$50,000 must file a Form 990N (the “e-Postcard”).²⁷⁴ IRS protocol set these limitations to reflect the heightened risk of abuse that results when 501(c) corporations hold receipts in excess of \$50,000. Because non-exempt clients of sponsoring organizations share similar risks, 501(c) revenue limits must apply to fiscal sponsorships arrangements as well. Thus, once the gross receipts of a

²⁷¹ See Link, *supra* note 120.

²⁷² David Swanson, *We Need ACORN*, DAVIDSWANSON.ORG (June 20, 2010), <http://www.davidswanson.org/node/2776>.

²⁷³ *Which Forms Do Exempt Organizations File?*, IRS.gov, [http://www.irs.gov/Charities-&-Non-Profits/Form-990-Series-Which-Forms-Do-Exempt-Organizations-File%3F-\(Filing-Phase-In\)](http://www.irs.gov/Charities-&-Non-Profits/Form-990-Series-Which-Forms-Do-Exempt-Organizations-File%3F-(Filing-Phase-In)) (last visited June 12, 2013).

Technically, they could file a regular 990 (rather than an EZ) if they choose to do so.

²⁷⁴ *Annual Electronic Filing Requirements for Small Exempt Organizations – Form 990-N (e-Postcard)*, IRS.GOV, [http://www.irs.gov/Charities-&-Non-Profits/Annual-Electronic-Filing-Requirement-for-Small-Exempt-Organizations--Form-990-N-\(e-Postcard\)](http://www.irs.gov/Charities-&-Non-Profits/Annual-Electronic-Filing-Requirement-for-Small-Exempt-Organizations--Form-990-N-(e-Postcard)) (last visited June 12, 2013).

project exceeds \$50,000, the 501(c)(3) sponsoring organization must be required to disclose this information in its Form 990.

Revenue limits would prevent the types of catastrophic losses experienced by projects of IHC and CCI. A cap on the gross receipts of a fiscally sponsored organization will also protect the funds it has accrued. The Religious Institute, for example, would not have lost over \$500,000 to CCI²⁷⁵, nor would the Afghan Women's Mission have lost \$400,000 to IHC.²⁷⁶ Under a fiscal sponsor, these large, successful projects not only supported other struggling nonprofit projects, but allowed their fiscal sponsors to prosper past what might be appropriate for a nonprofit organization. Large, national organizations such as ACORN have institutionalized fiscal sponsorship, allowing long-term fiscal sponsorship which eliminates any need for projects to apply for individual 501(c)(3) status. This prevents oversight of these organizations and accountability regarding their 501(c)(3) compliance. Temporary and limited fiscal sponsorship will prevent a lucrative industry from further arising through the subjugation of true nonprofit projects. These restrictions on fiscal sponsorship will make the process safer for projects, sponsors, and donors and will provide for proper oversight of the organizations receiving benefits.

D. The IRS Must Terminate Fiscal Sponsorships if the Facts and Circumstances Reveal Independence from the Sponsor.

Lastly, the IRS must terminate a sponsorship arrangement if the facts and circumstances reveal indicia, whether financial or otherwise, of independence from the sponsor sufficient to warrant separate corporate status. Such indicia may include, but are not limited to, separate: incorporation, bank accounts, accounting staff, human resources staff, legal officers, insurance, or office expenses. If the facts indicate that the sponsor is actually operating independently from the sponsoring organization, then there is no justification for a sponsorship relationship. Evidence of independence also raises the risk that the sponsored organization is controlling its sponsor. This was clearly the case with ACORN and re-branded ACORN groups which used fiscal sponsorship, not for administrative support, but merely as a conduit for tax-exempt donations by allowing the (c)(4) organization to control the (c)(3) sponsor.

IX. Conclusion

The original intent of fiscal sponsorship was to create opportunities for charitable projects to start their endeavors and give them the tools to become recognized and respectable charities and foundations. This intent has been subverted through the IRS's lack of oversight of these organizations, which allows for fraud, corruption, and money laundering. Additionally, the absence of clear definitions regarding the practice paves the way for scams, mismanagement, and general bewilderment for new projects attempting to further a nonprofit mission. Oversight, provided by more comprehensive Form 990s, and the enforcement of the temporary nature of fiscal sponsorship would prevent the fraud, corruption, and abuse of charitable projects and taxpayer funding which has become commonplace in recent years as a result of ACORN and its affiliates, IHC, CCI, and HIH.

²⁷⁵ Stockman, *supra* note 17.

²⁷⁶ Cohen, *supra* note 94.



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