People in Glass Houses

By Steven J. Willis

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Federal, state, and local governments subject charities to many complicated, technical, and often obscure rules. Many of those rules carry stiff penalties, out of proportion to the rules’ apparent importance. As a practical matter, charities often ignore rules such as those involving solicitation of contributions, sales tax, and the need for various operation and food permits. They do so with little risk: After all, who will pick on a Girl Scout bake sale simply because it lacks a solicitation permit and a state and local food inspection?

But controversial charities follow this trend of violations at their peril. In an age of gotcha journalism, groups such as the Boy Scouts must fear nongovernment scrutiny of their public behavior as much as — or more than — government scrutiny. Prof. Willis provides several small but nightmarish examples involving a Boy Scout car wash, a private school raffle, and a local environmental group doing battle with a cement plant. He then analyzes a large, controversial foundation based on publicly available documents. According to his analysis, the Bank of America Charitable Foundation Inc. lacks a valid charitable purpose and violates numerous civil rules regarding private inurement and self-dealing. He concludes the government should withdraw its exempt status and should subject both the organization and management to substantial taxes and civil penalties. He does not address the possibility of criminal liability.

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I. Introduction

A few months ago, the Bank of America Charitable Foundation (BACF) — a private nonoperating foundation — rejected a grant proposal from the Alapaha Area Council of the Boy Scouts of America.1 For several prior years, BACF supported the council generously. The denial resulted from a policy change made by the foundation’s board of directors: It would no longer support organizations that failed to comply with a newly adopted antidiscrimination policy.2

At the time, I’d never heard of BACF; however, I had heard of the Boy Scouts (having been one).3 As a regular teacher of tax-exempt organizations in the University of Florida Graduate Tax Program, I thought this might make an interesting case study. Indeed, it does.

What I know about BACF comes from what I’ve learned from various online sources, including BACF’s Web site,4 which is part of the Bank of America (BOA) Web site;5 the grant denial letter;6 and the entity’s Form 990-PF.7 Other information, to which I am not privy, may exist that may ameliorate some or all of my negative

1The council serves 12 counties in southern Georgia. A copy of the denial letter is available at http://nersp.osg.ufl.edu/~acadian/bankofamerica/BSletter.pdf.
2The policy requires that organizations not discriminate on the basis of race, religion, color, sex, sexual orientation, age, national origin, ancestry, citizenship, or veteran or disability status. Which policy the foundation believed the Boy Scouts violated was not stated in the letter; however, a subsequent public statement from the Bank of America (BOA) suggested it resulted from the Boy Scouts of America’s restrictions on openly gay males being adult leaders. Kelli Hernandez, “Scouts Denied Funding,” The Valdosta Daily Times, May 18, 2006. The statement was issued by Alex Liftman, a public spokesman for the BOA, according to numerous news reports (many not dealing with the Boy Scout funding issue).
3In the interest of full disclosure, I am an assistant scoutmaster, a troop committee member, and a committee member of a Cub Scout pack. Technically, I am a scouter and the proud father of a First Class Scout.
4http://www.bankofamerica.com/.
5http://www.bankofamerica.com/.
7A copy of the foundation’s most recent Form 990 is available at http://nersp.osg.ufl.edu/~acadian/bankofamerica/baf2004990.pdf.
observations. However, on the public record, BACF
Charitable Foundation is a case study in how not to
operate a private foundation. In the best light — resolv-
ing all issues in its favor — BACF appears to be at serious
risk of a rigorous audit. After all, it has the burden of
proof in tax matters and it has created a public persona
that, on its face, violates many tax provisions.

In the worst light, BACF may be subject to taxes of up
to eight figures — in excess of $300 million, and possibly
up to the amount of its net assets (which may soon pass
a billion dollars).8 Yes, that is B for billion. The board of
directors may also be subject, individually, for excise
taxes and penalties — totaling many tens of thousands of
dollars, and perhaps a million in the worst case. Yes, I
said the members of the board of directors may be personally
liable for taxes up to $1 million.

Granted, this is assuming the worst on all issues;
however, that is the way many of us teach. Take a real-life
scenario and assume the worst: Just how bad can it be? It
tends to focus the classroom. All competent lawyers
practice in an analogous manner: Assume the worst,
explain the nightmare scenario to the client, and plan on
how to avoid it. Whoever created the BACF appears, at
least from the public record, to have violated that rule.

This article has three parts:
• background information about private foundations;
• nightmare scenarios involving smaller organiza-
tions; and
• the BACF nightmare.

II. Background

For the uninitiated in the tax law of charities, section
501(c)(3) organizations are the ones that can receive
deductible contributions.9 They come in two basic fla-
ers: public charities and private foundations. Public
charities are those that are not private foundations (PFs).
PFs are charities that generally fail to satisfy a public
support test.10 Because they lack the natural oversight
supposedly inherent in public support, the government
imposes many more rules on them; essentially, it keeps
closer tabs.

To be concise, PF status is not a good thing. It results
in at least 21 disadvantages, compared with public char-
ity status:

1. Section 170(e) reduces charitable contributions to
PFs to the extent the property donated would
produce non-long-term capital gain if sold.
2. For most contributions, section 170(e)(1) reduces
contributions to PFs of related tangible personal
property to the extent the property donated would
produce long-term capital gain.
3. Section 170(b)(1)(B) limits contributions to PFs of
non-long-term capital assets to at most 30 percent
of the donor’s contribution base.
4. Section 170(b)(1)(D) limits contributions to PFs of
long-term capital assets to at most 20 percent of
the donor’s contribution base.
5. Charitable contributions to PFs are deducted
after contributions to public charities; hence, they
are more likely to be carried over and potentially
lost.
6. Section 4940 imposes an “audit tax” of between 0
percent and 2 percent of PF net investment income.
7. Section 4941 imposes a tax on PF self-dealing
with a disqualified person.
8. Section 4942 imposes a tax on PF undistributed
income, generally necessitating the annual distribu-
tion of amounts equal to 5 percent of the value of PF
investment assets.
9. Section 4943 imposes a tax on PF excess business
holdings, generally limiting ownership in a corpo-
ratio or partnership to 20 percent (when combined
with the interests of disqualified persons).
10. Section 4944 imposes a tax on jeopardizing
expenditures.
11. Section 4945 imposes a tax on grants to indi-
viduals that fail to satisfy the requirements of
section 4945(g).
12. Section 4945 imposes a tax on grants to organi-
zations unless the foundation exercises expenditure
responsibility.
13. Section 4945 imposes a tax on lobbying expen-
ditures.
14. Section 4946 effectively requires the PF to main-
tain a detailed list of disqualified persons.
15. Section 4940 effectively requires the PF to main-
tain a detailed list of disqualified individuals.
16. Section 4943 forbids any PF ownership in a sole
proprietorship, which effectively eliminates the
possibility of the PF having an unrelated trade or
business.
17. A section 501(h) election regarding lobbying is
not available to a PF.
18. Section 6684 imposes a penalty equal to any tax
imposed by sections 4941 through 4945 if the
foundation has been subject to such a tax previously
or if the act precipitating the tax was willful and
flagrant.
19. Section 507 makes voluntarily termination of PF
status very difficult.

8BACF’s 2004 Form 990PF lists its assets at $77,860,108.
According to the BACF Web site, the foundation has set a goal
of reaching $1.5 billion within 10 years.
9This is a small generalization. Technically, section 170(c)
organizations may receive deductible contributions, and section
501(c)(3) charities are one of four types of 170(c) entities. They
are, however, the dominant type. For more complete informa-
tion, see Darryl K. Jones, Steven J. Willis, David A. Brennen, and
Beverly J. Moran, The Tax Law of Charities and Other Exempt
Organizations, Thompson/West (2005).
10Section 509(a) supplies two alternative public support tests.
The technical requirements of the 509(a)(1) test actually appear
in reg. section 1.170A-9, while the technical requirements of the
509(a)(2) test appear in section 509 itself. Section 509(a)(3)
applies an alternate test for organizations controlled by publicly
supported charities or, in some cases, organizations described in
sections 501(c)(4)(S) or (6).

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20. Section 507 imposes a termination tax for willful and flagrant acts subjecting the foundation to tax under sections 4941 through 4945 or for willful repeated acts.

21. Form 990PF is significantly more complicated than Form 990 for public charities.

Admittedly, PFs have some advantage for lawyers and accountants: because of the serious risks involved in representing them, they require much more oversight by qualified professionals. Hence, they generate significantly higher legal and accounting fees. Indeed, the point of this article is a demonstration on how not to advise a private foundation. An analysis of the public record suggests that BACF could use — and certainly could afford — substantially more oversight from its tax professionals.

PFs also have one advantage for donors, and it’s a big one: They permit donors to deduct their contributions and still maintain control over them. This I generally, and admittedly pejoratively, refer to under the rubric of “ego.” In my experience, donors who give money to public charities receive thanks, sometimes gushing and sometimes merely tepid. Large donors are wined and dined as long as the charity smells money. When contributions dry up, solicitors move on. That is human nature and not meant to be harsh; it’s the way the world works. Donors to public charities who want to be wined and dined long term must hand out their donations over time, which defers the deductions and tax advantages. But donors to PFs, particularly the nonoperating type, can take their deductions currently and then dole out the contributed funds over time, enjoying the best of both worlds. As stated above, that egoism comes at a significant but apparently affordable price (considering the thousands of existing PFs).

Clearly, I do not like PFs. In an ideal world, Congress would repeal code sections that permit them and would require all charities to satisfy a more rigorous public support test. That world, however, is not likely to exist soon. In the meantime, as an educator and author, I must teach about them and other charities.

III. Other Nightmare Scenarios

To fully understand the BACF nightmare, we should first glance at some smaller-scale nightmares involving lesser charities, including public charities, and also some simpler issues. Three familiar and real scenarios come to mind. The facts undoubtedly repeat themselves across the United States regularly. Each involves a small somewhat innocent publicly popular charity committing or almost committing a crime. To make things worse, each involves nonlawyers who stubbornly refuse to listen to, or who only reluctantly listen to, the reality of laws governing charities. The purpose of this discussion is to illustrate that even the smallest of charities, with few resources, can easily get into trouble without careful and competent advice. Later, I will demonstrate how a large charity, such as BACF, with huge resources, can also easily get into much more significant trouble.

A. Boy Scout Car Wash

The facts are simple and common enough: A group of kids want to have a car wash to raise money. A local business says, “Sure, come on over and we’ll supply the water and parking lot.” That sounds good unless one of the assistant scoutmasters happens to be a tax lawyer. If so, he asks silly questions like these: “Do you have a city permit to do this?” “Have you complied with the Department of Agriculture rules governing charitable solicitation?”

“Are you seriously going to have boys hold homemade signs standing on a public sidewalk asking passersby to have their cars washed?” My experience tells me that nonlawyers regard such questions as annoying. Lawyers, however, are often paid to be annoying.

Many cities and counties in the United States require permits for charitable solicitations. While those ordinances are seldom enforced, they still exist and still threaten significant penalties. At least 40 states regulate charitable solicitation statewide, with significant reporting and disclosure rules. In Florida, one must have a permit to solicit charitable contributions on public roadways, including sidewalks. Further, only persons over the age of 18 may do so, they must wear an orange vest, and they must have a copy of any required permit. Never mind that I haven’t once seen anyone fully comply with those rules in my 25 years in Florida. Never mind that I’ve seen it violated, oh, perhaps a few thousand times. It’s still a misdemeanor not to have the orange vest and the permit. To involve minors in the commission of a crime makes things worse in ways I don’t even want to research. To commit a crime in the process of soliciting for charitable contributions violates state law and is a felony.

But “who cares?” you ask. “No police officer will arrest and no prosecutor will prosecute a bunch of scouts for a car wash.” I suggest such thinking is naïve.

The nightmare I envision is a drive-by shooting involving an obsessive-compulsive activist who hates the Boy Scouts. (Yes, they exist.) The drive-by would be a photo shoot and would end up in the newspaper, courtesy of a like-minded reporter looking for a Pulitzer. (They exist, too.) The caption would be “Scout Master Uses Local Boys in Commission of Felony.” Who cares what the fine print says? The damage would be done and would be irrevocable. Of course no one would prosecute; but of what consolation is that in a world of “gotcha

12Yes, indeed, the Florida Department of Agriculture and Consumer Protection regulates charitable solicitation in Florida. Violation of the rules is a third-degree felony punishable by up to five years in prison. See Florida Statutes, chapter 496.

13F.S. 337.406. In contrast, F.S. 316.2045 exempts section 501(c)(3) organizations that are properly registered with the Department of Consumer Services from the requirement of a permit for solicitation on non-state-maintained roads. Also, note the Florida attorney general opinion that casts some doubt on the constitutionality of the restrictions on charitable solicitations. AGO 2003-32 (July 18, 2003).
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journalism? People would remember “Scout Master” and “Boys” and “Felony.” It makes me want a Xanax just writing about it. So we make the boys step a few feet off the sidewalk (if I can get the other adults to comprehend the risks, without laughing me out of the room first).

B. PTA Raffle

Like it or not, gambling is a crime in most states. The numbers racket is almost universally illegal unless run by the state. That typically includes raffles run by churches, PTA groups, and local bar associations. In Florida, if the tickets are reasonably and realistically available for free, and they contain the proper disclosures, and they are distributed by a permitted organization, and they comply with the Department of Agriculture (DOA) rules, and they do not require the winner’s presence to win — well, then they are OK. I’ve seen many hundreds of those tickets are reasonably and realistically available for free, PTA groups, and local bar associations. In Florida, if the state. That typically includes raffles run by churches, PTAs, and local bar associations. Some even attempted compliance with the freebie requirement. None, that I have seen, fully and adequately succeeded with compliance, however. Not one.

Here’s the scary part. Schools are exempt from some but not all of the rules governing charitable solicitation. PTA groups, however, are not schools. They support schools, but they are not themselves schools. So let’s say the PTA group for a prominent local private school has the elementary school kids sell some tickets. It’s kind of cute and it is only a dollar. But . . . oops! We have no local permit, let alone a copy in everyone’s possession. We haven’t complied with the state charitable solicitation act. We’re running the numbers in a way not unlike Al Capone. And we use children — third graders! — to do it. For goodness’ sake, we even raffle a few bottles of wine and think it’s cute when a fifth grader wins!

“That’s unrealistic,” you say. “No one cares.” Oh, really? Pose some competition among local private schools, eager for students and tuition money. Don’t think they play dirty sometimes? If not, you hang around with a lot nicer people than I do. And a photograph of a kid winning a bottle of wine in an illegal gambling operation would not be nice (even if Dad were three feet away, conveniently cropped out of the picture).

I recall a widely reported incident about 15 years ago involving an “organized crime gambling operation” shut down in a local bust. Turned out an angry police chief (or some other official) had it in for a group placing small bets on the NCAA basketball tournament at a local tavern. The group comprised a bunch of lawyers and a few judges. All pleaded guilty to misdemeanor after seeing their photographs in the paper. Over the top, maybe . . . but it happened. The pictures were not pretty. Now imagine if they were children.

I also recall a prosecutor in a nearby county who shut down a few church raffles and PTA “racketeering operations” when they refused to give him a free ticket. The story was funny at the time, but the criminal charges remained. A crime is still a crime and one never knows quite when it might be enforced. In my experience, however, charities almost never listen when advised not to violate gambling laws.

C. CRAP

A few years ago, a cement manufacturer applied for a permit to build a cement plant in a small Florida town. Some locals were eager for the jobs. Others were aghast at the pollution potential. Ultimately, the plant builders won. But the process was, at times, ugly. Opponents created Citizens Righteously Against Pollution — or some similarly named organization — to raise money, picket, and stop the building. They properly applied for and received section 501(c)(3) status. They took out advertisements in the local paper seeking contributions. That’s where I stepped in.

Being a busybody, I called the advertised telephone number and asked for whatever information I was then entitled to receive under state law: a financial report, mostly. I knew the ad did not comply with DOA rules and I strongly suspected my request would not be met joyfully. Alas, it was not. After the initial demand that I cease harassing the organization, the representative and I calmly spoke. I explained that I was just a college professor testing the charitable solicitation act and that I had no intention of causing trouble. I suggested the organization seek the advice of competent counsel. The representative said they already had an attorney, so I repeated my advice.

But what if I did have bad intentions? What if I represented the cement manufacturer? Did I not catch them in the commission of a couple of felonies? The ad was not in compliance and they refused to send requested information. With a clever public relations firm and contacts within the state attorney’s office or attorney general’s office (or some other enforcement agency — I’m sure I could have found one) could I not have caused a lot of trouble and embarrassment? It may be a technical felony not to comply with the act, but it is still a felony in Florida (as is true in many states) to solicit charitable contributions without proper disclosures required by law. My students tend to think I’m too cynical to believe anyone would practice law or business in such a cutthroat manner, turning in the opposition. Am I too cynical? I think not. I think we live in a tough world with lots of technical (and not so technical) traps for the unwary.

IV. Bank of America Charitable Foundation

A. General Remarks

That brings me back to the subject at hand. The BACF and BOA picked on the Boy Scouts. Whether or not that was justified is beside the point of this article; the bank and the foundation each have a right to spend its own money as it deems fit. The bank, however, does not have a right to spend the foundation’s money for its own purposes. And people who live in glass houses need to be careful about casting stones: They might get noticed by a professor who needs a classroom example and who is motivated to cast a few back.

One might fairly ask, “Just how clean are BOA and BACF?” After all, they have taken advantage of very substantial deductions and exemptions from tax involving many hundreds of millions of dollars. It seems fair to ask whether those deductions and exemptions were legitimate. I suggest they were not.
My conclusions are harsh. Some conclusions are in the alternative.\(^\text{14}\) In my opinion, BACF lacks a valid charitable purpose and thus should be denied exempt status retroactively under the organizational test of section 501(c)(3). BACF violates both the commerciality doctrine and the prohibition against private inurement and thus should be denied exempt status under the operational test of section 501(c)(3). From what I can discern, BACF appears to have failed to file returns for, and failed to pay tax on, substantial unrelated business taxable income. It should be subject to tax, with interest and penalties. BACF’s actions appear to have violated section 4941 restrictions on self-dealing, resulting in taxes owed by BACF and by its directors and managers. Because those violations likely have not been corrected as required by section 4941(b), BACF and its directors and managers should be subject to failure-to-correct taxes. Because the actions appear to be repeated and willful, the 4941 taxes should be doubled under section 6654. BACF appears to have violated the section 4943 restrictions on excess business holdings, resulting in a substantial tax owed. Because that action does not appear to have been corrected as required by statute, BACF should be subject to a failure-to-correct tax. Again, because the actions appear both willful and repeated, the taxes should be doubled under section 6654. Lastly, because BACF has been repeatedly subject to chapter 42 excise taxes, it should be subject to a termination tax under section 507(d). The amount of that tax would equal all the tax benefits BACF or any substantial contributor ever received from the exempt status. The limit on that tax would be BACF’s net assets, which, according to BOA’s Web site, will soon approach $1.5 billion. The termination tax, however, would be in addition to other taxes owed.

That’s the argument. Now, let’s look at the publicly available evidence.

Before I do so, let me state one caveat: Perhaps BOA and BACF have a private letter ruling or rulings validating all those actions. While I believe the chances of that approach are absolute zero, I admit it is conceivable. If so, whoever issued such a ruling on behalf of the IRS should be fired.

B. Proof

1. Lack of a charitable purpose. Section 501(c)(3) fundamentally requires a charity to have a charitable purpose. This is part of the organizational test for charities. Without that purpose, the entity should not be exempt, and its exempt status, if granted, should be revoked.

Permitted purposes are “religious, charitable, scientific, testing for public safety, literary, or educational . . . or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals.” Nowhere does it say “the promotion of commercial banking operations.”

Yet, why was the BACF created? For altruistic reasons? Does anyone believe that? I suggest not. Consider some facts:

a. The name of the entity is the same as the major founder, BOA. Standing alone, that is not impermissible. However, it indicates an original desire to identify the charity with the bank and to promote the public image of the bank. What other possible reason exists to use the name? For example, consider Ronald McDonald House (RMH) — a well-known charity heavily supported by McDonald’s Corp. RMH, too, should raise some eyebrows over the use of the corporate symbol — the clown Ronald McDonald. However, the entity could plausibly argue an important noncommercial reason for the use of the name: its popularity with children. Kids love clowns and kids tend to love McDonald’s. The charity supports housing near hospitals for families of kids with serious illnesses. It provides a homey atmosphere for the families and sometimes the children. Understandably, the use of a happy, smiling, fun, and popular well-known clown as a symbol may help the emotional outlook of the children. I don’t know whether that is the justification offered by RMH or even whether it is winnable if challenged. I do know, however, that I could argue it with a straight face.

But what is the possible justification for the use of the corporate name Bank of America in BACF? In the best light, it smacks of commercialism as one of the purposes of the organization. In the worst light, it smacks of commercialism as the primary or sole purpose of the organization. Regardless, the exempt status should fail: Section 501(c)(3) charities are not permitted a single substantial noncharitable purpose.\(^\text{15}\)

b. BACF and BOA share the same Web site; indeed, the entire BACF site is merely a series of subpages accessed through the BOA Web site.

The BACF Form 990-PF for 2004 lists the foundation’s Web site as “http://www.bankofamerica.com/foundation”.

Again, standing alone, that is not offensive. But the site designer did not even attempt to separate the two entities. Throughout the site, they appear as one and the same. Indeed, clicking on “Home” on the BACF site takes the user to the BOA home. The search engine for information is the same — not just identical, but the same code. It does not reload between the BACF site and the BOA site because the two are not separate sites. If one clicks on “locations” on the foundation site, one might reasonably expect to find locations for the foundation offices. Instead, the following appears:

\[^\text{14}\]For example, if the entity were to lose its exempt status retroactively, it would be subject to corporate taxes on income but would unlikely be subject to taxes imposed on exempt organizations, including PFs.

\[^\text{15}\]Section 501(c)(3) requires an entity to be “exclusively” charitable. Reg. section 1.501(c)(3)-1(b)(1)(iii) essentially modifies that requirement to one that precludes substantial nonexempt purposes. See also Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945). “The enduring black letter lesson of Better Business Bureau is that the presence of a single non-exempt purpose, ‘if substantial in nature’ will preclude tax exemption no matter how many exempt purposes are present.” Jones, Willis, Brennen, and Moran, The Tax Law of Charities and Other Exempt Organizations, at 169-170 (West 2004).
Click on “Sign In” on the foundation web site and one gets:

This takes the user to:

The above appears on every page purporting to belong to BACF. In the best light, this is sloppy Web design. In the worst light, it is a claim of ownership to the intellectual property represented by the Web site: In other words, the bank owns the information and site, not the foundation.

Also appearing on each page of the foundation Web site is:

In the best light, that again makes the two entities appear to be one. In the worst light, it is flagrant.

d. BACF uses the same address as BOA. At least this is the address used on the foundation stationary:

In the best light, the Web designer received no legal guidance whatsoever. In the worst light, BOA is once again brazen in its disregard for the legal requirement that the foundation be a separate entity created solely for charitable purposes. Further, the above logo is a hot link to the BOA Web site home page. How could anyone deny that a purpose of the site is the promotion of the bank? Even if that involves sloppiness on the part of the design team, it still hurts: A principal is responsible for the actions of its agents.

Someone with subpoena power could check the Internet history of various corporate officers and foundation officers. Have they ever viewed the site? Did they ever click on the logo or the link “Home”? It would be important evidence that a significant purpose of the site was the promotion of the bank. It would also be interesting to know about other users of the site: How often did potential grant applicants go to the BOA site directly from the BACF site? If the number is significant — as it almost certainly is — it is evidence of private inurement (see below), the existence of which is evidence of an original lack of having solely charitable purposes.

In the best light, the Web designer was unaware of the legal significance of separate corporate identities and the particular need for a PF and a substantial contributor to be and to appear to be separate. In the worst light, the two simply did not care about being separate entities because they never intended to be separate entities: BOA and BACF are one and the same.

Someone with subpoena power might find some interesting memos from bank and foundation officers approving the design of the Web site. That might shed light on whether it involved low-level design mistakes or represented high-level corporate policy. If the latter is true — as I suspect it is — those memos will raise serious questions about the application of negligence penalties or worse: Someone may have signed forms attesting to the charity solely having charitable purposes when he knew full well that it did not. Those signatures were likely under penalty of perjury.

And where is the lawyer in all this? Did he not look at the client’s Web site and provide some common-sense advice? For $500 an hour, I would be happy to.

We could also check Internet history of various potential grant applicants. How many went directly to the BOA site? The answer would be significant.

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e. BACF makes grants only in areas that have a BOA branch. This statement appears on the BACF Web site: “Your organization must be based and serve communities in the areas where Bank of America currently does business in the United States.” Also on the Web site’s FAQs is the following:

For goodness’ sake, how blatantly commercial can they be? Could anyone argue with a straight face that the foundation making those grants does not at least, in part, exist to promote the bank? What would happen if the foundation board of directors decided to change this policy? It seems reasonable to believe the bank might stop the action.

Also on the BACF Web site is the following:

Just whose “Neighborhood Excellence Initiative” is it? Does it belong to the bank or to the foundation? The above comments suggest the program belongs to the bank; however, the Web site on which this appears is the foundation’s Web site, indicating foundation ownership:

http://www.bankofamerica.com/foundation/index.cfm?template=fd_neighborexcell

The six-page brochure describing the “Neighborhood Excellence Initiative,” however, is written almost entirely in the name of the bank rather than that of the foundation:

Notice that the BOA — not the BACF — claims to make the grants.

The brochure, however, also refers to the foundation a few times:

1. In a reference for more information, it sends the reader to:

2. The brochure states:

But in a particularly vague passage, the BOA-BACF brochure includes the following:

Finally, this information appears under FAQs for the foundation:

So... whose foundation and grants are these? Do the grants come from the bank or from the foundation? Is there any difference? The bank clearly takes credit for them in the brochure, even though it requires application through the foundation. Is this just another example of very sloppy design or is it intentional? In the best light, the future tense in the above FAQ suggests that perhaps this is a bank program to be transferred to and taken over by the foundation. In the worst light, the bank and foundation act as one and the same entity. The bank claims to own and run the foundation and its grants. A few subpoenas could easily get to the bottom of this.

f. BACF uses a press spokesman who is an employee of BOA. Following the denial of the grant to the Boy Scouts in Georgia, BACF issued a statement through Alex Liftman, a public spokesman for BOA, defending the foundation’s actions. Why did the foundation not use its own spokesperson to issue the press release? Why use a bank employee? Did the foundation approve the press release? While the answers to these questions are not
publicly evident, the legitimacy of the questions suggests at least a gross lack of oversight and at worst the lack of a charitable purpose.

In the best light, this person works for both entities and his role was misattributed by the press. In the worst light, the bank treats the foundation as its own property and defends it with its own resources and employees whenever it desires.

g. The denial letter suggests that BOA directs BACF’s policies.

h. BACF has used a BOA officer to write letters to grant applicants. The following was the closing of the denial letter addressed to the Boy Scout Council:

A source who knows Michael Harpe told me that Harpe is not an employee of the foundation; instead, he works for the bank. Mixing employees strikes me, in the best light, as unwise. It is evidence that the bank and foundation act as if they are one.

i. BACF uses the BOA logo on its stationery. Here is the top part of the foundation’s stationery:

Because this comes from the foundation, it is particularly disturbing: It suggests that the foundation also views itself as an arm of the bank rather than as a separate entity. This one is hard to view in a good light because it appears to be everyday stationery; hence, how could officers of the foundation be unaware of it? They might plausibly claim not to look at their own Web site, but could they claim not to look at letters they sign? Surely they could not, unless all letters are machine-signed, as the above one appears to have been.

j. BOA promotes BACF referring to it as its own. This statement appears on what purports to be the Web site for the foundation (emphasis added):

Because this comes from the foundation, it is particularly disturbing: It suggests that the foundation also views itself as an arm of the bank rather than as a separate entity. This one is hard to view in a good light because it appears to be everyday stationery; hence, how could officers of the foundation be unaware of it? They might plausibly claim not to look at their own Web site, but could they claim not to look at letters they sign? Surely they could not, unless all letters are machine-signed, as the above one appears to have been.

k. BOA claims to direct BACF for its commercial benefit. The following statement appears on the first page of the foundation’s Web site. This is a part of the bank’s Web site. The statement is in the name of the bank. Notice the pronoun “we” refers to the bank, not to the foundation. Focus on the highlighted words. They clearly state the bank’s concern that its own business success depends on the success of the funding it directs through the foundation. This is remarkable in its admission of the foundation existing to serve a commercial purpose. It is also remarkable in its admission of the bank directing the foundation to serve that commercial purpose.

Throughout our history, Bank of America has sought opportunities to touch the communities in which we do business, helping them grow and prosper. We understand the important stake we have in our neighborhoods. We also understand that the success of our business is hinged on the success of these neighborhoods. Through our charitable giving programs, we are able to direct financial and human resources to the places and people we serve. The Bank of America Charitable Foundation is one of the largest Corporate Foundations in the country. In 2004, we
announced an unprecedented $1.5B, 10-year goal for philanthropic giving (emphasis added).

A much smaller but factually similar case comes to mind: KJ’S Fund Raisers, Inc. v. Commissioner, T.C. Memo. 1997-424, Doc 97-26712, 97 TNT 184-12. The matter involved an entity that also sold lottery and other gambling paraphernalia to raise funds for charity. The organization operated out of a Vermont tavern, KJ’s Place. The court explained:

The organization’s purpose, rather than the nature of its activities, determines whether the organization is entitled to tax-exempt status. B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352, 356-357 (1978). Even an organization engaged in only one activity may have multiple purposes for that activity. Copyright Clearance Center, Inc. v. Commissioner, 79 T.C. 793, 803 (1982). A single nonexempt purpose, if substantial in nature, will disqualify an organization from qualification under section 501(c)(3). Better Business Bureau v. United States, 326 U.S. 279, 283, 66 S.Ct. 112, 90 L.Ed. 67 (1945). Determining the purpose of the organization is a factual question which concerns "both the actual as well as the stated purposes for the existence of the organization and the activities it engages in to accomplish those purposes." Christian Manner International, Inc. v. Commissioner, 71 T.C. 661, 668, 1979 WL 3825 (1979) (emphasis added).16

Notice the bold language and ask yourself whether the benefit to the BOA is substantial? Of course it is. The bank even admits it. KJ’s Place indirectly benefited from lottery ticket sales because the sales drew people to the bar. The court explained further:

Petitioner’s case is factually similar to P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984). In that case, the taxpayer was a nonprofit corporation formed to raise money for college scholarships. It planned to raise money through the operation of bingo games held at the Pastime Lounge, a lounge owned by two members of the board of directors. The other board members consisted of an accountant and director of the lounge and two “bingo players.” The board was self-perpetuating, with the existing directors selecting future directors. Id. at 197.

The owners of the Pastime Lounge ran the bingo games during regular business hours. Employees of the Pastime Lounge solicited orders for food and drink from the bingo players. However, the accounts of the Pastime Lounge were kept separate and distinct from those of the taxpayer....

This Court held that the taxpayer had a nonexempt purpose which was “substantial in nature”; i.e., to promote business at the Pastime Lounge through the medium of the bingo games.... The Court based this conclusion in part on the identity of the taxpayer’s board of directors with the owners and associates of the Pastime Lounge. Since the owners controlled the board and appointed its future directors, the Court reasoned, the taxpayer’s activities could be used to the advantage of the Lounge.17

Whether it is raising money for scholarships to sell drinks or helping neighborhoods to sell banking services, the bottom line is the same: The entity exists to serve a substantial nonexempt purpose. As a result, exemption is not proper — not for KJ’s Fund Raisers, not for the P.L.L. Scholarship Fund, and not for the BACF.

2. Private inurement. The previous section — which dealt with the lack of a charitable purpose — applies the organizational test for charities. Even if the foundation were to overcome the above-described problems, it would still violate the operational test. In short, the organizational test examines how and why an entity was created initially. The operational test examines how it actually operates in practice, after creation. One part of the operational test involves private inurement.

Section 501(c)(3) proscribes charities, including PFs, from providing any “net earnings... which inures to the benefit of any private shareholder or individual.” In simple terms, that prohibits a charity from benefiting directly or indirectly any stakeholders such as founders, directors, officers, or major contributors.18 Enforcement is spotty because the consequences are so harsh: Violation of the private inurement rules results in revocation of exempt status. No intermediate step is available for punishment; it is all or nothing, acceptance or revocation.19 As a result, Congress added to the code section 4958, which imposes an excise tax on excess benefit transactions. That is essentially the otherwise missing intermediate sanctions for private inurement violations. Section 4958, however, applies only to public charities: It has no application to PFs such as the Bank of America Foundation.

Although litigation construing the private inurement rules is sparse, a recent case helped explain the reach of “insiders” affected by the rules. In the 1999 United Cancer Council case, the Seventh Circuit Court of Appeals stated:

A charity is not to siphon its earnings to its founder, or the members of its board, or their families, or anyone else fairly to be described as an insider, that is, as the equivalent of an owner or manager. The test is functional. It looks to the reality of control rather than to the insider’s place in a formal table of organization.20

Unquestionably, Bank of America is such an “insider” in relation to the BACF. The corporation was a principal founder, a substantial contributor, and by nearly all

17Id.
18Reg. section 1.501(a)-1(c) states: “The words private shareholder or individual... refer to persons having a personal and private interest in the activities of the organization.”
19Of course, the IRS can warn an organization through its audit procedures and has broad discretion to settle such matters.
public appearances, as documented above, exercises significant control over the foundation. If this does not satisfy the functional test of insider, then little will.

That settled, let’s examine whether BOA receives any benefit from the Bank of America Foundation:

1. The foundation Web site and other publications actively promote the BOA through the prominent use of the bank’s logo:

   Arguably, that amounts only to a corporate sponsorship permitted by section 513(i). Two problems exist with that argument:

   a. The number of uses of the logo and the prominence given it trigger section 513(i)(1)(B)(ii)(I), which excludes “any payment which entitles the payor to the use or acknowledgement of the name or logo (or product lines) of the payor’s trade or business in regularly scheduled and printed material published by or on behalf of the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization.” As shown earlier, the logo — along with other bank statements — appears on every page of the foundation’s Web site, on the foundation’s stationery, and in various foundation publications — none of which are associated with a “specific event.”

   b. Whether the section 513(i) provisions permitting qualified sponsorship payments apply to PFs is doubtful. The permitted payments are an exception to the unrelated trade or business rules of sections 511 through 514; however, section 4943, which deals with excess business holdings, specifically precludes a PF from having any interest in a sole proprietorship. The plain meaning of that provision is to prohibit PFs from having any unrelated business activities whatsoever, not simply an “insubstantial” amount, as is true of public charities. Remember, the corporate sponsorship rules are an exception to the unrelated business rules, which do not themselves apply to PFs. Hence, if the main rule is irrelevant, logically, the exception to the rule is equally irrelevant. Following that logic, this amounts to private inurement.

2. The foundation operates only in areas in which the bank also operates. While this policy may exist because it promotes efficiencies in the use of shared employees, it also results in financial benefit to the bank. Charitable grants and other expenditures are prominently announced and promoted in places where the bank does business. One would have to be truly naïve to believe that this does not help the bank financially. Many authorities explain that the net earnings factor of private inurement applies very broadly; All that is needed to trigger the provision is a benefit to an insider — not necessarily any earnings or distribution.

3. Prominent links on the foundation’s Web site take the user to commercial pages promoting substantial banking services, such as ATMs, checking accounts, and investment and portfolio management services. Indeed, as shown above, if a user clicks on “locations” for the foundation, he is taken to:

   Similarly, the links to commercial banking operations and locations demonstrate the commercial usefulness of the foundation. At best, this could be defended as sloppy Web design and incompetent managerial oversight. On its face, however, it violates the commerciality doctrine and should result in revocation of the exemption.

3. Violation of the commerciality doctrine. Another aspect of the operational test for charities involves the commerciality doctrine. In essence, a charity must operate exclusively for a charitable rather than a commercial purpose. While no authorities clearly define the term “exclusively,” we know that it means “more than substantially.” Violation of the commerciality doctrine, if enforced, results in revocation of exempt status. No other penalty is available.

   Consider the above facts that demonstrate both the lack of a charitable purpose and also private inurement. Those facts also demonstrate the foundation’s violation of the commerciality doctrine. Whatever the subjective purpose for the organization, the actual operation of the foundation is intricately intertwined with the operation of the bank. The bank consistently refers to the charity as “our foundation” and how the foundation fulfills the bank’s corporate goals:

   Similarly, the links to commercial banking operations and locations demonstrate the commercial usefulness of the foundation. At best, this could be defended as sloppy Web design and incompetent managerial oversight. On its face, however, it violates the commerciality doctrine and should result in revocation of the exemption.

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21See Rev. Rul. 71-395, 1971-2 C.B. 228 (an art gallery organized by a group of artists violated both the organizational and operational tests: It was organized to benefit the artist/founders and it actually benefited them); Rev. Rul. 69-545, 1969-2 C.B. 117 (describing a violation of the private benefit rules, which are related to the private inurement rules); Ginsberg v. Commissioner, 46 T.C. 47 (1966) (dredging near the founders’ property resulted in forbidden benefits to the founders and also demonstrated the lack of a charitable purpose).
4. **Unrelated business taxable income.** Sections 511 through 514 impose a tax on the unrelated business taxable income of exempt organizations. The Bank of America Foundation Form 990-PF does not disclose any such income. Further, it does not show where or when the foundation has paid the appropriate taxes on such income. I have not located a Form 990-T on which such income and tax would be reported by the foundation. Indeed, the foundation’s latest available Form 990-PF specifically states that no unrelated business income existed for that period and no taxes were paid. Someone signed that form under penalty of perjury.

The signature is not publicly available; however, it appears to have been a senior vice president — someone who will have difficulty with an “I was sloppy and stupid” defense.

Yet, how else can a reasonable observer view the persistent use of the bank’s logo and repeated links to banking operations? Could anyone who is not incredibly gullible believe that those were not part of an agreement — whether written or unwritten — to the effect that the bank would contribute lots of money and the foundation would help promote the bank? Someone with subpoena power could likely find out for certain whether such an agreement exists. In the meantime, I would enjoy hearing the foundation’s defense of why this is not advertising income. Remember, the promotions far exceed what is permitted by the corporate sponsorship safe harbor provision.

5. **Self-dealing.** PFs and their managers are subject to an excise tax on self-dealing transactions under section 4941. That tax is much more intrusive than the more generally applicable proscriptions against private inurement discussed above. Section 4941(d)(1)(C) includes as self-dealing the “furnishing of goods, services, or facilities between a private foundation and a disqualified person.”

Several problems readily appear regarding the relationship between BACF and BOA:

1. The foundation provides endorsements and advertising for BOA.
2. The foundation provides special programs for BOA employees.
3. The foundation helps fulfill the BOA “corporate” philosophy.
4. The foundation makes grants only in communities served by BOA.
5. BOA provides Web space to the foundation.
6. BOA provides office space to the foundation.
7. BOA provides press spokesperson services to the foundation.

Under section 4941(d)(2)(D), the first four items listed escape self-dealing taxes only if they are “made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public.” Although I have not asked, I suspect the foundation would be reluctant to provide me with the same promotional benefits it provides to the bank, such as logo use and the like. Hence, that appears to be self-dealing. If, perchance, the foundation fairly charges the bank for the use of its logo and other promotional activities, the activities would escape self-dealing taxes, assuming other members of the public have the same opportunities — including, for example, Chase Bank or Wachovia.

I suspect we’ll wait quite some time before we see the Wachovia logo prominently displayed on the Bank of America Foundation Web site. In any event, such a fee arrangement would deepen the hole of unrelated business taxable income, if not also the commerciality doctrine.

The final three items escape self-dealing taxes under section 4941(d)(2)(C) if they are “without charge” and used “exclusively” for charitable purposes. While I do not know for sure, I suspect the services are indeed provided free of charge; however, as demonstrated elsewhere, the foundation uses the Web space and facilities at least in part to promote the bank, which violates a reasonable construction of the word “exclusively.” Hence, all seven examples appear to be acts of self-dealing.

The excise taxes for self-dealing are no small matter. Per section 4941(a)(1), the initial tax is 10 percent of the amount involved per act per year in the tax period (5 percent for periods before August 2006). The tax period runs from the date of the act and ends on assessment of the tax, correction (undoing) of the act, or the issuance of a notice of deficiency regarding the act. Further, each year in which self-dealing takes place constitutes a new act.

Suppose the advertising/promotional services provided to BOA by the foundation were valued, in combination, at $1 million in 2003. The initial tax on the foundation would be $50,000 for 2003, $50,000 for 2004, $50,000 for 2005, and more than $50,000 for 2006, for a total of more than $200,000. But if the same services occurred in 2004, that would be a new act, resulting in taxes of $150,000. The 2005 act would result in $100,000 tax, and the 2006 act would result in tax of more than $50,000. That totals to more than $500,000. Under section 4941(b)(1), the foundation will be subject to an additional tax of 200 percent of the amount involved if the acts are not properly corrected within the correction period. Assuming that does not occur, the tax on the above value would be $8 million, for a total of $8.5 million.

But things only go downhill from here. Section 6684 provides:

If any person becomes liable for tax under any section of chapter 42...by reason of any act or failure to act which is not due to reasonable cause and either —

(1) such person has therefore been liable for tax under such chapter, or
(2) such act or failure to act is both willful and flagrant,

Then such person shall be liable for a penalty equal to the amount of such tax.
First, the seven acts described above do not appear to be due to any apparent reasonable cause; at best, they result from negligence, which is not generally legally "reasonable." Second, the foundation appears to have been subject to the tax for numerous acts committed over several years. Whether the acts are both willful and flagrant is unclear: Flagrant seems plausible, while willful would depend on some degree of understanding or knowledge. In any event, because the acts are repeated and not reasonable, they appear to trigger the penalty. As a result, the hypothesized tax would double to $17 million.

And then we go further downhill. Section 4941(a)(2) applies a separate excise tax on foundation managers who approved the self-dealing transactions. That tax amounts to 5 percent of the amount involved per year, with a cap of $20,000 per act (2.5 percent and $10,000 for periods before August 2006). The nightmare for the foundation’s board of directors would involve the definition and valuation of an act. Arguably every letter on the letterhead was an act, as was each viewing on the Web site and each publication that contained the bank’s logo. The number of acts each year could thus be large and each act could involve several years during the correction period. For example a year 2003 act of using the letterhead would involve four years through 2006; hence, the percentage of the amount involved would be 10 percent (4 times 2.5 percent). Section 4941(b)(2) raises the amount to 50 percent of the amount involved for uncorrected acts. That, too, is capped at $20,000 per act ($10,000 before August 2006).

At the very least, the ads on the Web, on the brochure, and on the letterhead should each trigger $10,000 excise tax for each act. If each year is a separate act, that could easily amount to $100,000 or more of excise liability for members of the board of directors. As is true of the tax on the foundation, section 6684 imposes a penalty equal to the tax for repeated violation not due to reasonable cause. Because no defense for the violations is apparent, the directors’ liability would thus appear to be at least $200,000.

Again, things get worse for the foundation. Section 507 imposes a termination tax on PFs that have committed either “willful repeated” acts or a single “willful and flagrant” act giving rise to a chapter 42 tax. Certainly, the self-dealing acts are repeated. Whether they were willful might be arguable; however, I cannot imagine the argument they were not willful. Someone designed the Web site and the brochures and the letterhead. They did not accidentally place the logos on those things. Arguably, the foundation’s “locations” link that takes a user to ATM locations could be accidental — albeit horribly negligent. After all, it involves HTML computer code that might not be obvious to responsible persons. But the letterhead and the appearance of the brochures and Web site are open and obvious: Managers who signed letters could hardly argue that they were unaware of the logo on the paper they were signing. Whether they ever viewed the Web site should be a matter of record subject to the government’s subpoena power.

Hence, proper application of the termination tax seems plausible. The amount of the tax equals all the benefits the foundation and all substantial contributors ever received from the section 501(c)(3) status of the organization. If the assets of the foundation are worth $200 million, they have potentially resulted in $70 million of tax benefit to those who contributed them. Annual income for the foundation during 2004 was $116 million; thus, it must have escaped $40 million in income tax because of its exempt status.

6. Excess business holdings. Section 4943 restricts the holdings a PF and disqualified persons may have in various entities. For sole proprietorships, the permitted holdings are zero. The promotional activities by the foundation on behalf of the bank appear to constitute advertising, which is a common trade or business. Because the foundation has no apparent separate entity conducting those activities, it must be conducting them as a sole proprietorship.

The initial tax on the promotional business would be 5 percent of the value. For uncorrected acts, which these would appear to be, the tax is 200 percent of the amount involved. Section 6684 would impose a penalty equal to the tax if the act — or any act under chapter 42 — was repeated and not due to reasonable cause. Hence, the 205 percent tax quickly becomes a 410 percent tax.

The value of the promotional activities is difficult to gauge; however, the bank contributed $44,236,062 to the foundation though the end of 2004, which provides a beginning value of what the bank considered the value of the foundation to the bank to be. With interest, the section 4943 excise tax and section 6684 penalties could easily approach $200 million. That would be in addition to the section 4941 taxes, which I estimated at $17 million, and the termination tax, which could exceed $110 million. Add interest, along with failure to file and failure to pay penalties, and we quickly consume the current net assets of the foundation — perhaps $300 million or more.

Conclusion

The numbers I use are very large — even shocking. The issues, however, are serious and should not be ignored. Small organizations with which I associate spend considerable time following the rules. We comply, as best we can, with overregulation and arguably silly rules requiring permits and vests and magic words to solicit contributions. I expect my students to understand the law and how to comply with it. Whether they choose to comply with the full letter of the law is up to them and their own ethical standards balanced with some common sense. At least, I believe, they try to act in good faith.

The Bank of America and Bank of America Foundation, however, do not appear to have even tried to comply with the law. Based on the public record, I can make a plausible case of their liability for more than $300 million in taxes and penalties (to say nothing of the hundreds of thousands of dollars arguably owed by members of the foundation’s board of directors). Perhaps the entities can defend some of their actions. Perhaps I overstate the value of the advertising. Perhaps the true amount owed is only $100 million or $50 million. In any event, it is certainly a huge amount.

Interestingly, the BACF had no qualms about attacking others regarding their moral standards. The foundation, its directors, and its founder (the bank) appear unfazed by clear civil statutory requirements. Notice that
I’ve not even covered possible criminal liability for failure to file returns or to pay tax. The parties appear to have no problem operating a large charitable foundation to promote the interests of a commercial bank. It will be interesting to see whether the IRS tolerates this behavior. If it does, I need to change how I teach my classes.