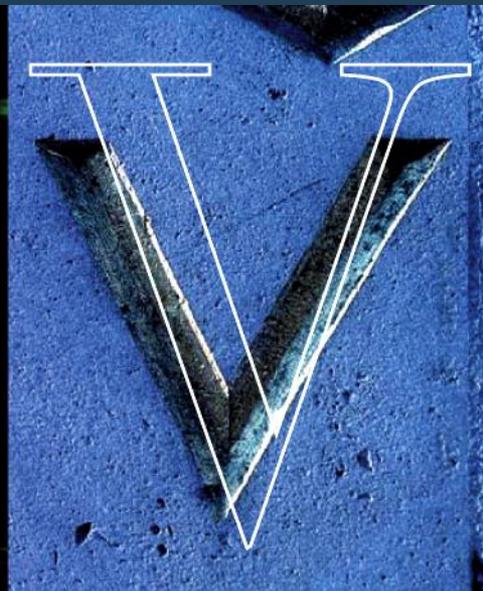
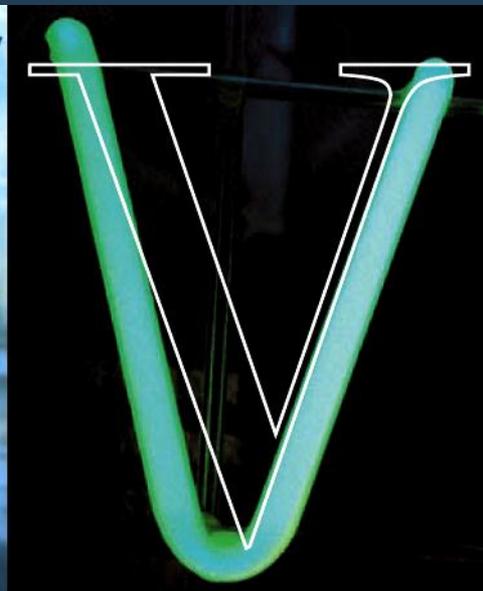
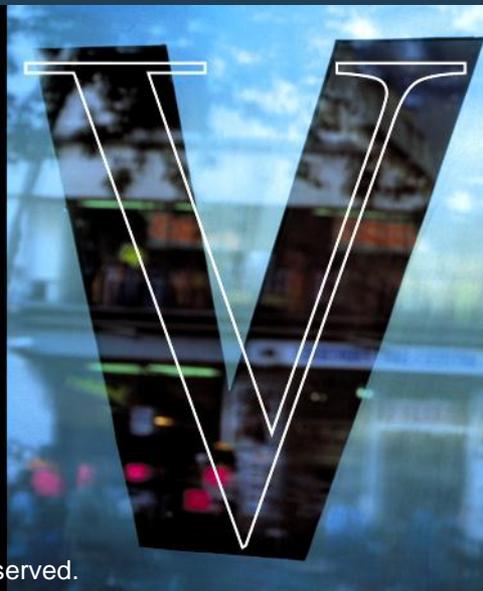
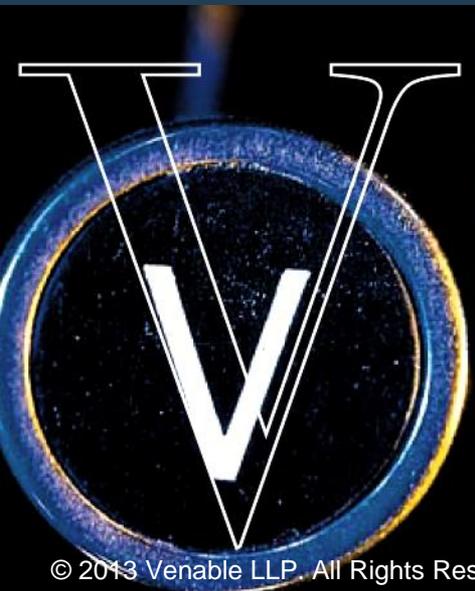


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Protecting Tax-Exempt Status: The Importance of Intangible Asset Valuation

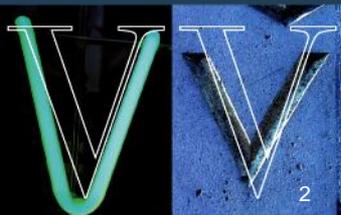
Matthew T. Journy, Esq.
Venable LLP

New York State Society of CPAs
FAE Conference Center
New York, NY
January 28, 2013, 9:00 am ET



Purpose

- Explain the consequences of entering into transactions without properly valuing all organization assets
- Explain the types of asset valuation relating to transactions commonly scrutinized by the IRS



Potential Tax Consequences Resulting from Failure to Properly Value Assets



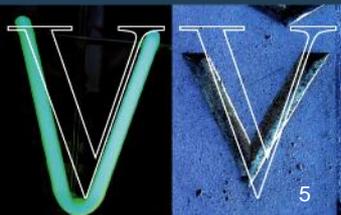
Potential Consequences

- Tax-Exemption issues
 - Private inurement
 - Impermissible private benefit
- Intermediate Sanctions



Exemption Issues

- Private Inurement
 - Code generally provides that no part of organization's net earnings can inure to the benefit of any private individual or shareholder
 - Applies to organizations exempt under multiple sections of the Code, including but not limited to: 501(c)(3), 501(c)(4), 501(c)(6), and 501(c)(7)
- Impermissible Private Benefit



Exemption Issues

- Impermissible Private Benefit
 - Generally, tax-exempt organizations are required to limit their activities to those that further their stated mission
 - A non-exempt purpose is generally a purpose that serves a private rather than a public benefit, as such is generally called a “private benefit”
 - Provision of an impermissible private benefit is grounds for revocation
 - The private benefit prohibition is imposed on a more limited group of exempt organizations than private inurement, and may not be applicable to organizations exempt under 501(c)(6) or 501(c)(7)



Intermediate Sanctions

- Internal Revenue Code (“Code”) section 4958 allows the Internal Revenue Service (“Service”) to impose penalties on “disqualified persons” who participate in or approve “excess benefit transactions”
- These penalties are commonly referred to as the intermediate sanctions
- Similar to “private inurement” concept



Intermediate Sanctions – Penalties

- Penalty for receipt of an excessive benefit:
 - Return the value of the excessive benefit to the organization; and
 - An excise tax of either:
 - 25% of the value of the excessive benefit if the benefit is returned to the organization prior to the issuance of a notice of deficiency by the Service, or
 - 200% of the value of the excessive benefit if the benefit is returned after the Service issues the notice of deficiency



Intermediate Sanctions – Penalties

- Penalty on organization managers for approval of an excessive benefit transaction:
 - Section 4958(a)(2) imposes a 10% tax on any organization manager that knowingly approves an excess benefit transaction



Why Valuations Are *EXTREMELY* Important



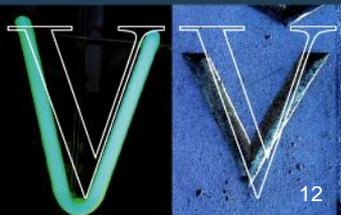
IRS Enforcement – Recent Litigation

- Reason for Transaction
 - Organization was a tax-exempt educational counseling organization
 - CEO's wife was the majority owner of a business that provided back-end services related to the organization's counseling program
 - Largest donor decided to withhold all contributions until the organization dissolved the contractual relationship with back-end service provider
 - Organization decided that it could not continue to exist without the continued support of its largest donor



IRS Enforcement – Recent Litigation

- Facts Regarding Transaction
 - The time remaining on contract between the organization and Service provider was three years
 - The cost of breaching was estimated to be \$2.2 million
 - At the time of the transaction, wife owed \$600,000 from the purchase of the company
 - Without obtaining a formal valuation, wife agreed to sell the service provider to the organization for the amount that she owed to prevent a personal loss and ensure the organization's continued existence



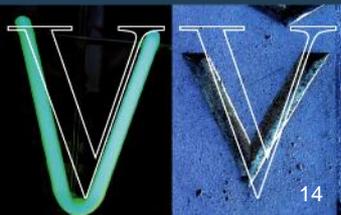
IRS Enforcement – Recent Litigation

- IRS Position
 - The value of agreement was \$0 because wife would not have sued an organization managed by her husband
 - Value of all assets, tangible and intangible, was \$15,000 (the amount listed in the contract)
 - Wife received an excess benefit of \$585,000
 - IRS issued a deficiency notice for \$1.3 million, plus interest
 - IRS internal expert valuation



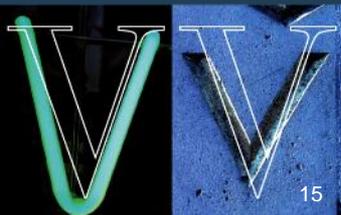
IRS Enforcement – Recent Litigation

- Facts During Litigation
 - Organization paid for two independent valuation reports, both demonstrated that the value of the company was in excess of \$800,000
 - IRS internal expert determined that value was in excess of \$700,000
 - IRS refused to consider the report of any expert and continued to assert that the value was \$0



IRS Enforcement – Recent Litigation

- Results
 - After almost two years of litigation, the IRS settled the case by fully conceding the deficiency
 - The taxpayer was not required to pay any amount of taxes or penalties, but paid hundreds of thousands of dollars in legal fees
- Lessons
 - A valuation before the transaction could have prevented a lot of stress and saved a lot of money



Common Transactions Involving Intangible Assets



Common Intangible Asset Transactions

- The sale of a membership list by an exempt organization to a taxable entity
- An exempt organization's licensing of its trademark or logo by a taxable entity
- The sale or license of software either from an exempt organization to a taxable entity (and vice versa)



Questions and Discussion

Venable LLP
575 7th St. NW
Washington, DC 20004
202.344.4000

Matthew T. Journey, Esq.
mjourney@Venable.com
t 202.344.4589

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