

Steve Leimberg's Charitable Planning Email Newsletter Archive Message #310

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Subject: Richard L. Fox on *Fumo v. Commissioner* - Disqualified Person Status Under IRC Section 4958 Can Arise Where a Person Has No Formal Position with a Charity

*“This case serves as a reminder that disqualified person status under IRC § 4958 can arise where a person has no formal position with a charity. The case also highlights that attempts to apply the meaning of “disqualified person” narrowly and to apply hyper-technical arguments in order to avoid such status are not likely to succeed where, regardless of whether a person lacks any formal affiliation with a charity, the facts and circumstances demonstrate, as was clearly the case *Fumo v. Comm’r*, that the person is in a position to exercise substantial influence over the affairs of the charity. Given the substantial penalties imposed under IRC § 4958, caution should clearly be exercised in determining the disqualified person status of a person who has any transactions with a charity.”*

Richard Fox provides members with commentary on [Fumo v. Commissioner](#).

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Here is his commentary:

EXECUTIVE SUMMARY:

In *Fumo v. Comm’r*, TC Memo. 2021-61 (May 17, 2021), the petitioner, Vincent J. Fumo, a former Pennsylvania State Senator, was convicted in federal court in March 2009 related to a scheme to defraud a local charity

of over \$1 million that was used to purchase vehicles, farm equipment, tools, and consumer goods for the petitioner's personal use and make other expenditures on his behalf. Following his conviction, the petitioner spent four years in federal prison and was released in August 2013.

In May 2013, the IRS determined that the petitioner was a “disqualified person” under the excess benefit transaction rules of IRC § 4958 and, as a result of such status and the misuse of the charity’s funds for his personal benefit, he was liable for substantial excise taxes. Although the petitioner was not an officer, director or employee of the charity, had no formal affiliation with the charity, and never contributed funds directly to the charity, the Tax Court determined that, based upon the facts and circumstances, he was in a position to exercise substantial influence over the affairs of the organization and, therefore, was a “disqualified person” subject to the excise tax provisions of IRC § 4958.

This case serves as a reminder that disqualified person status under IRC § 4958 can arise where a person has no formal position with a charity. The case also highlights that attempts to apply the meaning of “disqualified person” narrowly and to apply hyper-technical arguments in order to avoid such status are not likely to succeed where, regardless of whether a person lacks any formal affiliation with a charity, the facts and circumstances demonstrate, as was clearly the case *Fumo v. Comm’r*, that the person is in a position to exercise substantial influence over the affairs of the charity. Given the substantial penalties imposed under IRC § 4958, caution should clearly be exercised in determining the disqualified person status of a person who has any transactions with a charity.

FACTS:

Establishment and Funding of Citizens Alliance, an IRC § 501(c)(3) Tax-Exempt Organization

In *Fumo v. Comm’r*, TC Memo. 2021-61 (May 17, 2021), the petitioner, Vincent J. Fumo, was elected to the Pennsylvania State Senate in 1978, representing the first district in Philadelphia. Reelected many times, he served as a State Senator until 2008. His tenure ended in 2009 when he was convicted on Federal corruption charges and sentenced to 55 months in prison.

In 1991, at the petitioner's direction, three members of his senatorial staff incorporated a charity that later became known as Citizens Alliance for Better Neighborhoods ("Citizens Alliance"), an IRC § 501(c)(3) tax-exempt organization whose stated purpose was to maintain and improve the appearance of petitioner's senatorial district by cleaning streets, removing graffiti, shoveling snow, and carting away trash.

Frank DiCicco, then a member of petitioner's senatorial staff, was one of the organization's incorporators and served as its president from 1991 through 1999. Ruth Arnao, another one of the petitioner's staff member, was also an incorporator, listing her address as the address of petitioner's office in the first district. Ms. Arnao initially served as secretary of the organization and served during 2001-2004 as its executive director, all while remaining employed by petitioner.

The petitioner himself was never an officer, director, trustee, or employee of Citizens Alliance. However, it was determined that he used his power and influence as the chairman of a senate appropriations committee to obtain funding for the organization from a variety of public and private sources. During 1991-2004, he was instrumental in securing at least \$15 million in public grants for Citizens Alliance and a comparable volume of funding from private sources. This included a \$17 million grant from a public utility, which Citizens Alliance received after petitioner agreed to drop a lawsuit against the utility.

Conviction of Petitioner on Criminal Charges For Using Funds of Citizens Alliance for Personal Purposes

In February 2007, a grand jury charged petitioner with 139 counts of criminal activity. Thirty-four of these counts, on which Ms. Arnao was charged as a codefendant, related to a scheme to defraud Citizens Alliance. The indictment alleged that petitioner and Ms. Arnao conspired to use Citizens Alliance's funds to purchase vehicles, farm equipment, tools, and consumer goods for petitioner's personal use and make other expenditures on his behalf, including for foreign travel, the services of a private investigator, and cell phone service for his chauffeurs and daughter.

In March 2009, following a six-month trial, petitioner was convicted in federal court on all 34 counts related to the scheme to defraud Citizens

Alliance. After several appeals related to sentencing, petitioner was ultimately required to pay Citizens Alliance restitution of \$1,165,317. That was the amount of loss petitioner caused to the organization, as determined by the trial court.

Petitioner testified during his criminal trial that he considered Citizens Alliance a “constituent service” of his senate office and expected to derive political benefits from the work it performed in his district. Although Ms. Arnao exercised day-to-day control over the organization's affairs, petitioner approved most significant projects and directed many major expenditures, including purchase of the office building that housed his first district office.

Petitioner also testified that he received over the years many “perks and gifts” from Citizens Alliance. He owned several residences, including a farm near Harrisburg, and he was apparently something of a tool aficionado. He admitted at trial that, between 1998 and 2003, he received \$43,000 in tools paid for by Citizens Alliance. When he wanted the organization to purchase tools for him, he testified that he would email Ms. Arnao or another senate staff member, who would order the tools using Citizens Alliance's credit card.

Petitioner routinely enjoyed the use of trucks, minivans, and other vehicles owned or leased by Citizens Alliance. He admitted at trial that, in 2003, the organization paid for a bulldozer that was used exclusively on his farm. When the bulldozer broke down in December of that year, Citizens Alliance paid \$16,000 to repair it.

Petitioner admitted at trial that he “did have a significant role” in Citizens Alliance. While he “did not make all the decisions,” he “did make a lot of decisions on important topics.” As he explained: “I don't have a title or a job. Do I have influence? Yes.” When asked by his defense attorney to describe his relationship with Citizens Alliance, he stated: “I viewed it as my non-profit. I viewed it as my entity, my baby. Gave it birth and nursed it along, got involved more with strategy and ideas. You know, that's how we viewed it. And we ran it out of our office.”

During cross-examination, the prosecutor read to petitioner the definition of “disqualified person” as it appeared in the 2002 IRS Instructions to Form 990, Return of Organization Exempt from Income Tax: “A disqualified

person regarding any transactions is any person who is in a position to exercise substantial influence over the affairs of the ... organization at any time during a five year period ending on the date of the transaction.”

Petitioner replied: “I did have substantial influence over the organization. So according to that I am a disqualified person.”

Following his conviction, the petitioner spent four years in a federal prison and was released in August 2013.

Internal Revenue Service Determination That Petitioner Was Liable for Excise Taxes Under the Excess Benefit Transaction Rules of IRC § 4958

In May 2013, shortly after the petitioner’s release from federal prison, the IRS determined that the petitioner was liable for excise taxes under the excess benefit transaction rules of IRC § 4958(a)(1). That section imposes, in the case of each “excess benefit transaction” involving an IRC § 501(c)(3) tax-exempt organization, an excise tax equal to 25% of the excess benefit, and provides that such tax “***shall be paid by any disqualified person ... with respect to such transaction.***” (Emphasis added.) A potential 200% excise tax is imposed on the disqualified person under IRC § 4958(a)(2) where the excess benefit is not “corrected” within a specified “taxable period,” although the IRS considered the petitioner’s repayment of \$1,165,317 to Citizens Alliance to constitute “correction” of the excess benefit so that IRC § 4958(a)(2) was not applicable.

An “excess benefit transaction” for purposes of IRC § 4958 is defined to mean “any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.” As the court noted, an “applicable tax-exempt organization” is defined to include an organization, such as Citizens Alliance, described in section IRC § 501(c)(3) and exempt from tax under IRC § 501(a). In this case, absent the petitioner being classified as a disqualified person with respect to Citizens Alliance, no excise taxes could be imposed under IRC § 4958.

Decision of Tax Court Granting IRS Motion for Summary Judgment That Petitioner Was Disqualified Person Notwithstanding Lack of Any Formal Relationship with Citizens Alliance

In an attempt to avoid having to litigate the issue at trial, the IRS filed a motion for summary judgment with the Tax Court contending that there was no genuine dispute of fact as to the petitioner's status as a "disqualified person" with respect to Citizens Alliance and, as a matter of law, the petitioner was a disqualified person subject to excise tax under IRC § 4958. As discussed below, the court, finding that the petitioner was clearly in a position to exercise substantial influence over the affairs of the charity, had no hesitation in granting the motion for summary judgment sought by the IRS regarding the petitioner's status as a disqualified person.

In its opinion, the Tax Court first noted that the statutory definition of a "disqualified person" under IRC § 4958(f)(1) includes "any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, and then carefully reviewed the "comprehensive regulations" under IRC § 4958 addressing this issue, including the persons holding specified powers and responsibilities with respect to a charity that are deemed to be "in a position to exercise substantial influence over its affairs." Reg. § 53.4958-3(a)(1).

With respect to persons holding certain formal positions within the charity, the court noted that under Reg. § 53.4958-3(c), voting members of the governing body, presidents, chief executive officers, chief operating officers, treasurers, and chief financial officers are, by virtue of their powers, responsibilities, or interests in the charity, "in a position to exercise substantial influence over the affairs of a tax-exempt organization" and, therefore, are *per se* "disqualified persons" under IRC § 4958.

Apart from these enumerated officials who are deemed to be disqualified persons, the court, citing Reg. § 53.4958-3(a)(1), stated that the question of whether an individual is a disqualified person generally "depends upon all relevant facts and circumstances." Reg. § 53.4958-3(e)(1), the court noted, specifies a nonexclusive listing of factors "tending to show that a person has substantial influence over the affairs of an organization" which the court stated includes, but are not limited to, a person:

- Founding the organization;
- Being a substantial contributor to the organization;
- Having or sharing authority to determine a substantial portion of its capital expenditures or operating budget; or
- Managing a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization.

With respect to the first factor, the court pointed out a number of factors indicating that the petitioner was the founder of the charity. The petitioner admitted during his criminal trial that he “created” Citizens Alliance, “gave it birth,” and “nursed it along.” He regarded it as a “constituent service” designed to curry favor with voters in his district. The organization was incorporated at his direction by three members of his senatorial staff, two of whom listed his first district office as their address. He also testified that, “[i]f it weren't for me, ... [Citizens Alliance] wouldn't exist.” While noting that Citizens Alliance did not bear his name, that court stated that it seems clear that the petitioner in substance “founded the organization.”

The court then turned to the second factor listed in regulations which looks to whether a person is a substantial contributor to the organization, defined as a person who contributes as little as 2% its total contributions. Although the court stated that the petitioner does not appear to have donated money to Citizens Alliance directly, he admitted during his criminal trial that he “raised money for it.” Indeed, during 1991-2004, the court noted that he was instrumental in securing at least \$15 million in public grants for Citizens Alliance and a comparable volume of funding from private sources.

Although the court determined that the petitioner was not technically a substantial contributor because he did not actually make any contributions to Citizens Alliance, the court emphasized that the regulations provide that the facts and circumstances tending to show that a person has substantial influence “include, but are not limited to,” the factors listed therein and, as such, are non-exclusive.

The court found that the petitioner's role as the “chief fundraiser” for Citizens Alliance is an unlisted factor that strongly supports, by analogy

with the second listed factor, his status as a “disqualified person.” In this regard, the court indicated that the regulations providing that a 2% contributor will tend to have “substantial influence” over a charity is presumably because a threat by such a donor to terminate his current level of funding would give them meaningful leverage over the charity's decision making. Relatively speaking, the court stated, the “petitioner had much greater leverage over the affairs of Citizens Alliance because he was responsible for virtually all of its funding, albeit indirectly rather than directly.”

With respect to the factor listed in the regulations regarding a person having or sharing authority to determine a substantial portion of its capital expenditures or operating budget, the court found that the petitioner had such authority. While recognizing that the petitioner was not an officer, trustee or employee of Citizens Alliance and, therefore, lacked such authority in a formal sense, the court noted that he testified during his criminal trial that, while he did not have “a title or a job,” he “did make a lot of decisions on important topics.”

Apart from petitioner's direct role in making important decisions, the officers of Citizens Alliance who had day-to-day authority over budget and capital expenditures were subject to petitioner's control because they were his employees. Accordingly, the court found that the petitioner “ha[d] or share[d] authority to control or determine”—directly or indirectly—a substantial portion of Citizens Alliance's capital expenditures and operating budget.

Finally, the clearest indication according to the court that the petitioner was “in a position to exercise substantial influence over the affairs of the organization,” was “that he in fact exercised such influence, and did so repeatedly over a period of many years. The District Court in the criminal case determined that the benefits petitioner extracted from Citizens Alliance caused it to suffer a cumulative loss of \$1,165,317. He could not have achieved this feat without possessing “substantial influence” over the organization and its personnel.”

The petitioner’s principal argument for non-disqualified person treatment was that he “was neither an officer, employee, nor director” of Citizens Alliance and “held no formal position,” and that a person can only be a disqualified person if they are “formally affiliated with a charitable

organization.” According to the petitioner, the test under IRC § 4958 is not whether the individual “in fact ... manipulated substantial influence” over a charity, but whether he held a position that would enable him to wield substantial influence, thereby construing the word “position” under IRC § 4958 to mean “office” or “job title.”

In rejecting the petitioner’s argument, the court stated that the regulations make it clear that a person need not be an officer, director, or high-level employee of a charity to be a “disqualified person.” While persons holding official positions, such as CEOs and CFOs, are automatically deemed “disqualified persons” under Reg. § 53.4958-3(c), the court stated that the status of most other individuals is governed by the “facts and circumstances” test whereby an individual can be a “disqualified person” even though they have no formal job title or formal affiliation with the charity.

The court also pointed out examples in the regulations where persons having no formal affiliation may be considered a disqualified person depending upon the facts and circumstances. These include an artist who works only part time for a museum if the museum purchases a high-value painting from the artist and an outside contractor that operates bingo games for a charity, as well as the controlling shareholder of that outside contractor, where bingo revenues constitute most of the charity's total annual revenue. Reg. § 53.4958-3(c), Examples (2), (5) and (6). These examples, the court stated, show the error of petitioner's submission that an individual cannot be a “disqualified person” with respect to a charity unless they have a job title or other formal affiliation with it.

Finally, the court found the petitioner’s arguments for not classifying him as a disqualified person based on the fact that his staff members, not him, were the literal incorporators and that he was not technically the founder of the charity as unconvincing and constituting hyper-technical arguments that ignore the substance of what occurred.

COMMENT:

This case serves as a reminder that “disqualified person” status for purposes of the excess benefit transaction rules under IRC § 4958 can arise where a person has no formal position with a charity, such that a

person need not be an officer, director, or employee to attain such status. The case also highlights that attempts to apply the meaning of “disqualified person” narrowly and to apply hypertechnical arguments in order to avoid such status are not likely to succeed where, regardless of whether a person lacks any formal affiliation with a charity, the facts and circumstances demonstrate, as was clearly the case *Fumo v. Comm’r*, that the person is in a position to exercise substantial influence over the affairs of the charity. Given the substantial penalties imposed under IRC § 4958, caution should clearly be exercised in determining the disqualified person status of a person who engages in any transaction with a charity.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Richard Fox

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CITES:

[*Fumo v. Comm’r*, TC Memo. 2021-61](#); IRC § 501(c)(3); IRC § 501(a); IRC § 4958; Reg. § 53.4958-3; Reg. § 53.4958-3(c), Examples (2), (5) and (6).