

LEGAL UPDATES

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# U.S. Tax Court Finds "Disqualified Person" Definition for Nonprofit Excess Benefit Rules is Expansive

On May 17, 2021, the U.S. Tax Court issued a Memorandum Opinion in *Vincent J. Fumo v. Commissioner*, T.C. Memo. 2021-61, regarding the definition of a “disqualified person” under I.R.C. section 4958(a)(1). Managers of tax-exempt organizations should be aware of the opinion because it provides guidance as to when a person without formal affiliation with an organization will be held to be a disqualified person to whom the excess benefit transaction rules apply.

## Facts

Vincent Fumo, the petitioner, is a former Pennsylvania state senator who, in 2009, was convicted on Federal corruption charges and sentenced to prison. From approximately 1999-2004, members of his staff ran a tax-exempt 501(c)(3) charity which he had directed them to create. Although Fumo had no formal role, he used his role in the Pennsylvania State Senate to direct funds to the organization. He also received extensive benefits from the charity, including \$43,000 in tools and the use of charity-owned vehicles.

After Fumo’s criminal conviction, the Internal Revenue Service (IRS) sought to impose tax under I.R.C. section 4958(a)(1), which, among other things, imposes a 25 percent tax on any “excess benefit” received by a “disqualified person” from a charity, and requires the tax to be paid by the disqualified person (individuals receiving excess benefits are also required to repay those benefits; in this case, the transactions were deemed repaid by over \$1 million in restitution Fumo made to the charity).

The IRS moved for summary judgment on two issues, using materials including Fumo’s testimony in his criminal trial. First, the IRS sought a ruling

that Fumo was a disqualified person under section 4958. Second, the IRS sought a ruling that Fumo had in fact received some excess benefits from the charity.

### **Tax Court holding**

The Tax Court held that Fumo was a disqualified person in spite of his having no formal role in the organization. The Tax Court declined to rule on whether Fumo had received any excess benefit, deferring the determination on this issue to trial, when it would determine the exact amount of benefit, if any, that was received.

On the disqualified person question, the Tax Court considered Sec. 43.4958-3 of the Foundation Excise Tax Regulations. Even though Fumo was not a member of any governing body, and had no formal office with the organization, nor was he a family member, the Court considered whether, “under all facts and circumstances,” Fumo was a disqualified person. The Court considered the following factors, prescribed in the regulation:

The person founded the organization;

The person is a substantial contributor to the organization;

The person has or shares authority to determine a substantial portion of expenditures;

The person manages a discrete segment or activity of the organization that represents a substantial portion of assets, income or expenses.

The Court found that all of these factors weighed in favor of disqualified person status. Fumo was not a technical “incorporator” of the charity, but he directed its creation. Fumo did not directly contribute funds to the charity, but he raised funds on its behalf. Although he had no formal decision-making authority, in practice he had exerted significant authority over the charity’s major decisions. Although he argued his lack of a formal or direct role was significant, the Tax Court rejected this argument and found that there was no genuine issue of material fact as to whether, under all facts and circumstances, he exerted substantial influence over the organization and therefore was a disqualified person.

### **What this mean to you**

The facts of this case are extreme. Fumo was a convicted criminal with significant testimony that could be used against him regarding his role in the organization. But courts seldom have the opportunity to examine disputes over whether someone is or is not a disqualified person – there do not appear to be any other cases with any significant analysis of the issue.

The Tax Court's ruling here should serve as a reminder to exempt organizations that even someone with no formal role, or who does not contribute directly to an organization, may be a disqualified person for purposes of the excess benefit transaction rules. Organizations would do well to consider whether significant volunteers or fundraisers could be considered disqualified persons and to consult counsel if they are unsure.

### **Contact us**

If you have questions or concerns about your tax-exempt 501(c)(3) leadership, contact Robert Romashko, Rachel Scott or your Husch Blackwell attorney.