

Frequently Asked Questions for Proposed Position Statement 19-117

To authorize the RI Board to take appropriate action to change RI's tax status

What is the purpose of this item?

RI is currently tax exempt under Section 501(c)(4) of the US tax code. If approved, RI would convert to a Section 501(c)(3) tax exemption.

1. SAVINGS

What is the benefit of being tax exempt under Section 501(c)(3)?

RI could obtain several benefits as a 501(c)(3) organization that are not available to a 501(c)(4) organization:

- Favorable pricing from vendors – **Estimated US\$400,000 savings annually**
- Favorable tax treatment – **Estimated US\$275,000 savings annually**
- Eligibility for certain corporate sponsorships, which would increase revenue
- Opportunity for tax benefits for US tax payers that wish to support an RI activity

How would 501(c)(3) status affect vendor pricing?

Many vendors have a corporate philosophy of providing discounts to 501(c)(3) organizations and not 501(c)(4) organizations. This is likely because the vendors know that a 501(c)(3) entity is a charity vetted by the US Internal Revenue Service. A 501(c)(4) entity can be more or less charitable in nature and can in fact be political in nature. Microsoft, for example, has a bright line rule and provides the discounts for 501(c)(3) entities and not 501(c)(4) entities.

Will RI receive real estate tax exemption or sales tax exemption?

Real estate tax and sales tax exemptions are determined on a state-by-state basis in the US. It is unlikely that RI would obtain a real estate or sales tax exemption in Illinois. However, RI might obtain a sales tax exemption in other states. Thus, there could be significant tax savings depending upon where the International Assembly and the RI Convention are held in the US in the future.

Will RI dues be tax deductible for US Rotarians?

If the conversion is completed, RI will inform US Rotarians as to their ability to deduct RI dues. However, the amount of the tax savings would be minimal.

Can vendors contract with The Rotary Foundation, which could benefit RI through the Rotary Foundation/RI-cost-allocation system?

No. Vendors have specifically stated that they will not contract with The Rotary Foundation for services that will benefit RI and that they conduct audits of how their services are utilized.

Can corporations contribute to The Rotary Foundation now?

Yes. However, if RI were a 501(c)(3) organization, it could generate sponsorships for *RI* events and activities, such as the International Convention. Because RI is currently a 501(c)(4) organization, TRF funds cannot be used to support RI programs.

2. IMPACT ON RI

How would this affect Rotary International?

This would have no change in the operations or governance of Rotary International.

- The RI Constitution and Bylaws would remain in place.
- RI would continue to support clubs and districts in the manner it does currently.
- The annual International Convention and International Assembly would still occur.
- The Council on Legislation would still convene.
- The RI Board would continue to govern.

Will RI receive a Charity Navigator rating?

Charity Navigator is a private rating agency that reviews US charities and rates them on a scale of 1 to 4 stars. TRF is rated as a 4-star charity. RI would not immediately receive a Charity Navigator rating as Charity Navigator does not provide a rating until an organization has been in existence as a 501(c)(3) organization for 7 years.

Will RI be able to operate its programs and other activities the way it currently does?

Yes. RI will operate exactly as it does today. RI will be able to conduct the same activities that it does currently.

If Council approves the Proposal, when would RI's 501(c)(3) status be effective?

The Council action itself would not be effective until 1 July 2019. After that, there will be legal procedures necessary to complete the process. For instance, RI is waiting for the US Internal Revenue Service to approve a group exemption application to make sure that US clubs and districts remain exempt under Section 501(c)(4). While RI expects it to be granted, RI has to wait for the US Internal Revenue Service to notify RI. Then, there would also need to be an application sent to the State of Illinois to get approval of the change. Depending upon when all of this is successfully completed, the Board would determine the most effective date to complete the merger.

Will there be additional compliance obligations when RI is a Section 501(c)(3) organization?

There will be no significant additional compliance obligations. The tax reporting will be largely the same.

Will there be competition between RI and TRF?

A Joint Task Force (comprised equally of TRF Trustees and RI Directors) unanimously concluded that potential “competition” was not a significant issue because each organization has a different mission. TRF exists to do good in the world and so donations to TRF support TRF programs, such as PolioPlus and Global Grants. RI exists to run the business of Rotary and so donations to RI reduce its operating expenses. In addition, RI runs activities like the International Assembly, International Conventions, and youth programs. People or organizations may wish to contribute to these activities and, if RI is a 501(c)3, the contributing organization may get a tax benefit. The RI Board and TRF Trustees approved an Operating Agreement that assures there will be no competition.

3. IMPACT ON CLUBS AND DISTRICTS

How would this affect Rotary clubs and districts?

This would have no impact on clubs and districts.

Will this change the tax status for US clubs and districts?

No. US clubs and districts currently have the option of automatically being tax exempt under Section 501(c)(4). This will not change if this Proposal is adopted.

Will US clubs and districts also become Section 501(c)(3) organizations?

No. US clubs and districts will remain tax exempt under Section 501(c)(4).

Will this impact non-US Rotarians?

No. Non US clubs and districts will not be impacted. However, to the extent that RI saves money or receives more revenues from sponsorship, it will be to the benefit of all Rotarians.

Must RI’s and Rotary clubs’ activities be primarily charitable and RI’s and Rotary clubs’ funds be spent primarily for public charity activities?

RI’s 501(c)(3) application lists the numerous activities of RI and of Rotary clubs and notes that Rotary clubs would remain 501(c)(4) organizations. The US Internal Revenue Service agreed that the current operations of RI qualified it for 501(c)(3) recognition. The US Internal Revenue Service has also granted 501(c)(3) status to other service organizations.

The notion that Rotary clubs’ activities must be charitable is a misunderstanding of previous US Internal Revenue Service decisions. The US Internal Revenue Service has denied 501(c)(3) status to membership organizations that sought the exemption for the organization *and* its subordinate clubs. RI sought (and the US Internal Revenue Service granted) 501(c)(3) status for RI only, not Rotary clubs.

Are any other Rotary organizations 501(c)(3)s?

Yes. It appears that 8 zones in the US have obtained 501(c)(3) status for themselves.

4. IMPACT ON TRF

How would this affect The Rotary Foundation?

This would have no anticipated impact on The Rotary Foundation. The Foundation remains and will remain Rotary's primary charitable global fundraising vehicle. RI will work with The Rotary Foundation to assure that donors and potential donors are not confused as to the distinctive roles of RI and The Rotary Foundation. An Operating Agreement has been entered into between RI and TRF to assure that there would be no negative impact on TRF.

The Trustees of The Rotary Foundation endorse this Proposal.

Would this Proposal impact TRF's Charity Navigator rating?

There would of course be no change in TRF's rating because there would be no change to TRF's operations.

If RI were a Section 501(c)(3) organization, it would be subject to a rating by Charity Navigator. There has been concern expressed that this could create confusion with TRF's high rating from Charity Navigator.

Charity Navigator's rules for when it begins to rate Section 501(c)(3) organizations provide that there is no rating until the organization has filed a Form 990, Return of Organization Exempt from Income Tax, as a Section 501(c)(3) organization for 7 years. Thus, if RI were to convert to a Section 501(c)(3) organization by 30 June 2019 (the earliest possible date), it would file its first Form 990 in 2021 and its seventh Form 990 in 2027. So the earliest that a Charity Navigator rating would be issued would be in 2027.

The Joint Task Force recognized that by 2027 the entire Charity Navigator process could have been completely revised and thus it would not be possible to accurately estimate a rating for RI. It also recognized that any concern regarding confusion arising from a Charity Navigator rating would be essentially eliminated by the fact that there would be no rating for RI until, at earliest, 2027.

The Joint Task Force also noted that a search of the word "Rotary" in the Charity Navigator web site returns 10,179 entries, many of which are US Rotary clubs, club foundations and other Rotary related organizations. However, the vast majority of these have no ratings as they are either too small (Charity Navigator has a US\$1,000,000 annual revenue minimum threshold for ratings) or they are Section 501(c)(4) exempt organizations.

Could this Proposal have an impact on TRF's associate foundations?

No, this Proposal would have no impact on TRF's associate foundations.

Are there any plans for Rotary International and The Rotary Foundation to merge?

No. In any event, any potential merger would need to be approved by the Board, the trustees, as well as the Council on Legislation.

5. PROCESS

Was Rotary transparent to the US Internal Revenue Service?

What activities did RI disclose in its application to the US Internal Revenue Service?

RI disclosed the following activities, among others, to the US Internal Revenue Service:

- Rotary clubs unite dedicated individual volunteers to exchange ideas, build relationships, and take action by engaging in projects.
- RI supports Rotary clubs and districts in their pursuit of activities that promote the advancement of international understanding, goodwill, and peace, as well as the ideal of service in the lives of all individuals.
- RI holds various meetings, including the International Convention, the International Assembly, and the Council on Legislation.
- Rotary districts hold annual meetings for training and promoting Rotary goals.
- Rotaract clubs, Interact clubs, Rotary Youth Leadership Awards, and the Youth Exchange Program.
- *The Rotarian* magazine.

Why was a new shell corporation created?

The process followed was based on advice of outside counsel. This enabled the Board to first determine whether the US Internal Revenue Service would even approve the application for RI to become a Section 501(c)(3) organization without raising it to the Council. If the US Internal Revenue Service had rejected the application, there would not have been any need to waste the Council's time reviewing the item (which also allowed the Board to start the exploratory process more quickly).

Why is the Proposal presented to the Council on Legislation? Couldn't the RI Board implement this Proposal on its own?

The process that has been followed involves a merger between the existing Rotary International corporation and the newly formed Rotary International Holdings, NFP (RIH). The Council is Rotary's highest governance body, so it is appropriate that such a merger be approved by it.

How has the RI Board publicized its decision to convert its tax status?

All of the Board's decisions concerning this Proposal, dating back to 2016, were publicly available on Rotary's website. Additionally, the Board specifically informed The Rotary Foundation Trustees that it was considering its tax status in September 2016 and gave periodic updates thereafter. The Position Statement was published to Council representatives in the ordinary course of Council updates, after The Rotary Foundation gave its endorsement in January 2019.

Why would the proposal "reduce" or "cheapen" the status of RI (according to the opponents)?

This proposal would not reduce the status of RI. It would merely change the basis of its US income tax exemption from one section of the US Internal Revenue Code to another.

Who did Rotary consult?

Who is Rotary's attorney?

RI was advised by expert outside counsel who specializes in not-for-profit tax law and who has been representing Rotary for more than 35 years. Indeed, it is the same counsel who assisted in incorporating TRF and preparing TRF's 501(c)(3) tax exemption application in 1983.

Rotary's attorney, Michael Clark, is a partner in Sidley's Chicago office and a co-leader of the Non-Profit Institutions practice area team. Mr. Clark has experience in representing clients with respect to federal income tax controversies in litigation and in negotiations with the Internal Revenue Service. He also has extensive experience as tax counsel for tax-exempt organizations, including trade and professional associations.

Mr. Clark was selected by *Best Lawyers* as Chicago Non-Profit / Charities Law "Lawyer of the Year" for 2014, and has been listed in *Best Lawyers* since 2007 for Non-Profit / Charities Law - Churches, Education, Health Care, Private Foundations, Tax-Exempt Organizations. Mr. Clark has been a registered, certified public accountant in Illinois since 1976.

Who reviewed the Proposal?

The Proposal was reviewed by:

- A Joint Committee of 2 board members and 1 Trustee member
- The Joint Task Force to Review RI's Tax Status, comprised of 3 board members and 3 trustee members
- Outside legal counsel
- RI's and TRF's outside auditor – Deloitte
- Both the RI Board and TRF Trustees
- A Secretariat task force, which included staff from Finance, IT, legal, partnership, philanthropy

The process has taken over two and a half years since it began in April 2016.