



# Nonprofit Alert®

Alerting nonprofit leaders to key legal developments and responsive risk management steps.

## 1. Nonprofit Overview

### 1.1 Postal Service Backs Off Restrictions on "Premiums."

The Postal Service amended its rules last month to guarantee nonprofit rates to charities that offer small, low-cost gifts to donors (sometimes called "back-end premiums"). Examples of such gifts include tote bags, stationery, or books offered in exchange for charitable contributions. The amendments now allow the USPS to accept mail pieces that include or offer premiums if:

- ◆ the requested donation exceeds the total cost of the premium by at least five times; or
- ◆ in cases where the nonprofit specifies the value of the premium being offered in its mailing, then the contribution must exceed the stated value by at least three times.

Industry executives say this policy change paves the way for more creative nonprofit fund raising and solicitations. Although the amendment is subject to public comments through October, the USPS will not likely make any significant changes to the new policy.

★ **Nonprofits and the USPS long debated this issue, but the USPS didn't change its position until the Federal Trade Commission and the IRS issued recent advisory opinions saying back-end premiums are not regular sales transaction and, therefore, should not be subject to the same restrictions.**

### 1.2 Tax Court Reaffirms No UBIT on "Affinity" Credit Cards.

The U.S. Tax Court has once again ruled that proceeds nonprofits receive from "affinity" credit cards is royalty income, not subject to unrelated business income tax (UBIT). The case involved the alumni association at Mississippi State University, which sold lists of its members to People's Bank and Trust for credit card solicitations. The IRS argued that the alumni association entered a joint venture with the bank, making the proceeds from that arrangement taxable because the venture was unrelated to the association's exempt purpose. But the Tax Court ruled none of the association's activity triggered UBIT. *Mississippi State University Alumni Inc. v. Commissioner*, T.C. Memo. 1997-397.

★ **A similar case last year that involved Oregon State University resulted in the same ruling by the Tax Court (NPA, Mar. 96). Both these cases follow the legal reasoning of the landmark 1994 Sierra Club case. Still, the IRS continues to pursue this issue. These Tax Court rulings now stand as strong precedents, however,**

### Don't Miss . . .

- ★ **HIV-Positive Doesn't Equal Disability. . . . ¶3.1**
- ★ **UBIT: Art Shows, No; Concerts, Yes . . . . ¶4.1**
- ★ **Computers Qualify for More Deductions . . . ¶4.2**
- ★ **Colorado Revises Old Nonprofit Laws . . . . ¶5.2**

*...In This Issue of NPA*

securing a better position for nonprofits to challenge IRS assessments of this sort.



Recently revised NP9110-1, *A UBIT Primer for Nonprofits*, now features a new discussion of royalty income and other areas of potential UBIT.

## 2. Liability & Risk Management

### 2.1 College Controller Charged With Embezzling \$1.2 Million.

When an audit turned up numerous large checks paid to one individual, officials at Bethel College realized their controller had been embezzling funds for nearly four years. Controller Michael Lichtenberger had written unauthorized checks to himself from the college's payroll and operating accounts, then forged the signatures and deposited them into his own account. Officials at the private religious college in Kansas totaled the embezzled funds at about \$1.15 million. The college had bonded the controller for dishonest and criminal acts, but only for about half this amount.

★ **No system is foolproof against embezzlement, but well-conceived internal controls can substantially reduce this risk if they are faithfully implemented and periodically reviewed by an organization's board and executives.**



The Gammon & Grange Legal Audit asks key questions to assess the strength of internal controls and minimize the potential for costly and embarrassing diversions of nonprofit assets. For details, call Gammon & Grange, (703) 761-5000.



In addition to the Legal Audit, Nonprofit Alert Memo #9106-2, *Accounting and Fiduciary Guidelines*, introduces proper internal controls for nonprofits. See back page to order.

**2.2 Ruling Opens Door to Litigation Over Tax Exempt Bonds.**

Last month, Tennessee’s highest court ruled that certain revenue bonds issued on behalf of David Lipscomb University, a religious college affiliated with the Church of Christ, would have been taxable if the Industrial Development Board of Metropolitan Nashville hadn’t decided to issue them as tax-exempt. The ruling allows five Tennessee residents to go forward with a federal lawsuit claiming the bond offering constitutes an establishment of religion that violates the First Amendment. Since the state court said the bonds would otherwise have been taxable, their issuance as tax-exempt means the city and county lost revenues that affected the five residents filing the suit. This gives them standing to bring their claim in federal court.

★ **Although the interplay of federal and state laws is confusing in this case, the real issue is whether tax-exempt bonds can be offered on behalf of religious colleges through a government entity like an industrial development board. The outcome of this case could have widespread implications for religious colleges and nonprofits around the country if a federal court now decides that such bond issues violate the Establishment Clause.**

**3. Employees & Volunteers**

**3.1 HIV-Positive Not Covered by Disabilities Act, Court Rules.**

The Americans With Disabilities Act (ADA) does not cover employees infected with the HIV virus unless it has developed into AIDS, the 4th Circuit has ruled. The court said that being HIV-positive does not mean an individual suffers from an impairment that “substantially limits a major life activity,” a crucial test under the ADA law. The case involved a Maryland man who was diagnosed HIV-positive in 1988 but never experienced any symptoms. In 1991, he was hired to manage trust accounts at a bank but was fired in 1993 after his supervisor learned of his condition. The supervisor testified that she had already decided to terminate his employment for failure to meet sales goals before she learned of his condition. The employee sued, alleging discrimination under the ADA, but the court said “asymptomatic HIV infection will never qualify as an impairment.” The court also said the employee failed to show that his alleged impairment limited a major life activity or whether his employment termination occurred under circumstances that could be discriminatory. *Runnebaum v. NationsBank of MD*, VLW 097-2-211 (4th Cir., 1997).

➔ **The ADA covers many disabilities, including AIDS. For a complete summary, order NP9102-1, HIV/AIDS Policy for Nonprofit Employers. See back page to order.**

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**3.2 Failure to Mitigate Weakens Employee’s FMLA Claim.**

A federal court in Virginia awarded only \$2 to a female plaintiff who sued under the Family & Medical Leave Act because she failed to mitigate her damages during her unemployment. The plaintiff was working as a financial analyst at an oil company when she took six weeks of maternity leave under the FMLA. Afterwards, she claimed the company would not reinstate her. Evidence at trial suggested she made little or no effort to lessen her damages during her unemployment period. She convinced unemployment counselors she was looking for a job in order to collect the maximum unemployment benefits. A jury ruled in her favor on the FMLA claim, but found she suffered no damages. The court subsequently awarded her nominal damages of \$2, but granted nearly \$20,000 in attorney fees.

★ **The \$20,000 in attorney fees highlights a crucial aspect of the FMLA law. Unlike most employment laws, the FMLA contains specific instructions for the award of attorney fees when a party receives “any judgment.” The court said this includes judgments even when no damages are awarded. This means a nominal damage award may still result in a significant financial liability for the employer. *McConnell v. Miller Oil Co.*, VLW 097-3-180.**

➔ **The FMLA applies equally to nonprofits and commercial enterprises alike. To understand the practical application of the FMLA and how it impacts your organization, order the newly updated NP9407-1, All in the Family—Living With the Family & Medical Leave Act.**

**4. Tax-Exempt News & Issues**

**4.1 Property Rental for Art Shows OK, But Not For Concerts.**

The Tax Court has ruled that a nonprofit museum furthered its exempt purpose of introducing people to outdoor arts by renting space in its office building for public art events. Therefore, the rental income it received was exempt from unrelated business income tax (UBIT). However, income the museum received from a long-term lease with a concert promoter for the use of its outdoor amphitheater created UBIT because the activity constituted a trade or business unrelated to the museum’s exempt purpose. The lease made the museum responsible for maintaining parking and security for the concerts, plus providing assistance to the promoter in obtaining permits and licenses to hold the outdoor concerts. Ticket prices for the concerts were comparable to commercial prices and produced a substantial sum of money for the promoter and the museum. A portion of the lease payments was also tied to a percentage of profits the promoter received. All these factors pointed to a profit-making enterprise, rather than an exempt function, the court said. *John W. Madden, et. al., v. Commissioner*, T.C. Memo. 1997-395.


★ **Although an argument could be made that the concerts were within the museum’s exempt purpose of furthering an appreciation for the outdoor arts, the IRS found too many factors suggesting commercial activity.**

➔ **Like many areas of management, a little strategic planning can go a long way: had the museum performed a contract audit on how the outdoor concerts could promote their purpose of enhancing public appreciation of outdoor art, UBIT likely could have been avoided. To guide you in auditing**

**To guide you in auditing your organization's entrepreneurial activities, order NP9110-1, *A UBIT Primer for Nonprofits*.**

**4.2 Computer Gifts More Appealing Under New Tax Law.** In a little publicized section of the tax law passed this summer, gifts of computer technology or equipment that corporations give to certain schools may qualify for greater charitable deductions than previously allowed under the tax code. The new deduction will be equal to the lesser of the donor's basis in the equipment, plus half the equipment's appreciation (if any) up to two times the donor's basis. Other than computer equipment, no change was made to the tax rule that gifts of inventory are deductible only to the extent of the donor's basis in the property. The new rule is effective only for the 1998 and 1999 tax years, however. P.L. 105-34; IRC §170(e).

★ **A printing error in the tax law originally said the provision extended beyond 1999, but a technical corrections bill now pending in Congress corrects the error. Because of its limited window of opportunity, check with your accountant to coordinate proper timing if you are working with a donor who wants to contribute computer equipment.**

 **More general issues for nonprofits to consider when receiving inventory like computers are detailed in NP9109-6, *Gifts of Property*. See related story, ¶7.1.**


## 5. State Rules & Regulations

**5.1 Washington State Weighs Rules for "Coventurers."** New regulations under consideration by the Washington Secretary of State would require retailers to register as "commercial coventurers" if they advertise or operate any programs under which they make charitable contributions based on a percentage of sales.

A key factor is whether the promise to make contributions works as an inducement to purchase the retailers' goods or services. Retailers would file a simple registration and pay a \$20 fee to the state, but they would also be required to file copies of any agreements they have with charities specifying how the contributions are calculated and other details of the coventure program. Sec. of State, Prop. Rule, RCW 34.05.320.

**5.2 Colorado Revises Nonprofit Statutes After 30 Years.** For the first time since 1967, Colorado has recodified its nonprofit corporations act. The revisions give nonprofits greater flexibility to deal with conflicts of interest. Colo. S.B. 97-91.

★ **Because the revisions provide options for additional operating procedures, nonprofits may benefit from revising their own corporate documents to reflect the changes.**

 **If your organization operates in Colorado, call Gammon & Grange to see if the changes mean any measurable benefits for you or your members.**


**5.3 Pennsylvania Ends Tax Exemption on Religious Items.** A state sales tax exemption on the sale of religious articles, including Bibles, books and other publications, violates the state and federal constitutions, a Pennsylvania court has ruled. The court relied on various Supreme Court rulings to find that the state's tax exemption statute violates the First Amendment Establishment Clause. *Haller v. Commonwealth*, No. 241 M.D. 1993 (Pa.Comm. 1997).

★ **Income from the sale of Bibles and other religious articles in Pennsylvania is now subject to state sales tax. Nonprofits that sell such items are responsible for collecting the tax from consumers and remitting it to the state.**

### *NPA Highlight of the Month*

## Federal Religion Guidelines Destined for Private Workplace

In the wake of the Supreme Court's rejection of the Religious Freedom Restoration Act, President Clinton implemented federal guidelines on religious expression through a presidential order issued in August. While these guidelines apply only to federal agencies and employees, efforts are underway to duplicate the guidelines in the private sector, despite a failed attempt by the EEOC three years ago to impose religious expression guidelines on *all* employers, including nonprofits. Sens. Dan Coats (R-IN) and John Kerry (D-MA) have introduced the Workplace Religious Freedom Act to constitutionally protect religious observers in the workplace. The act would apply to all employers with 15 or more employees. Clinton's guidelines "clarify that federal employees may engage in personal religious expression to the greatest extent possible, consistent with workplace efficiency and the requirements of law," according to the President's statement. But many legal experts say the guidelines are too vague and, if applied to the private sector, could potentially create more avenues of conflict than they resolve. For instance, several parts of the guidelines advise supervisors to balance an employee's religious expression against the government's interest in efficient operations, but there is little or no explanation about how to define that balance. The Workplace Religious Freedom Act avoids that problem by taking into account a number of factors, including the cost of accommodating religious observers, as determined by the costs of lost productivity and the costs of retraining, rehiring, and/or transferring employees.


 **For a complete outline of all federal laws that require employers to implement antidiscrimination policies, order NP9312-1, *Avoiding Employment Discrimination in the Nonprofit Organization*. For guidance regarding *bona fide* religious selectivity by religious organizations order NP9103-1, *The Right of Religious Employers to Select Employees Based on Religion*. See back page to order both memos.**

## 6. Gifts & Fund Raising

**6.1 Easier Tax Laws Encourage Charitable Giving.** The Taxpayer Relief Act, signed into law this summer, contained a wide assortment of tax breaks, including some that encourage charitable giving. The act retroactively extended the special tax break for donations of qualified appreciated stock to private foundations until July 1, 1998. Another provision of the law eliminates the requirement for donors to file gift tax returns for gifts made after August 5, 1997, if the gift is made outright to charity and amounts to the taxpayer's entire interest in the gift. Split-interest gifts must still be reported, however. Prior to this revision, taxpayers had to file gift tax returns to report any gift in excess of \$10,000 per year per donee, even if the donee was a charity. (See related story, ¶7.1, below).

**6.2 Planned Giving Gets Boost From Montana Legislature.** Taxpayers in Montana may now claim up to \$10,000 in charitable credits for contributions to planned giving funds of nonprofits in the state, thanks to a law passed earlier this year. The law allows donors, including corporations and partnerships, to claim credits against state income taxes, up to 50% of the present value of the charitable amounts of their planned gifts. The credit applies only to contributions made through planned giving techniques recognized in the federal tax code, such as charitable gift annuities and pooled income funds. The law is retroactive to January 1, but it expires December 31, 2001. Any Montana charity organized as a 501(c)(3), or any fund held by a bank or trust company to benefit such organizations, qualify if its planned giving program is a permanently restricted fund.

★ **Combined with the favorable tax treatment that planned gifts receive at the federal level, this tax break offers an attractive incentive to both corporate and individual donors. If your organization operates planned giving in Montana, this could accelerate endowments over the next five years.**


 **Considering planned giving? First review NP9301-3, Pooled Income Funds: Long-Term Fund Raisers for Nonprofits, and NP9403-2, Charitable Gift Annuities.**

## 7. Executive Items of Interest

**7.1 Quote of the Month.** "CHARITIES MUST GRAPPLE WITH THE NUTS AND BOLTS OF THE DETAILED LEGISLATION . . . ALTHOUGH THE CHANGES WILL PROBABLY NOT HAVE A SIGNIFICANT EFFECT ON THE TOTAL AMOUNT THAT PEOPLE GIVE TO CHARITY, THEY WILL MOST CERTAINLY HAVE AN IMMEDIATE AND MAJOR IMPACT ON THE TYPES OF GIFTS THAT PEOPLE MAKE, ON WHY THEY CHOOSE TO GIVE, AND ON THE FINANCIAL VEHICLES THEY USE TO MAKE THEM." — Robert F. Sharpe, Jr., commenting in *The Chronicle of Philanthropy* on the Taxpayer Relief Act of 1997. See related stories, ¶4.2 & ¶6.1, above.

### 7.2 Internet Newsletter Offers Tips on Federal

**Grants.** The Federal Information Exchange, a private company based in Gaithersburg, MD, is offering a free internet newsletter that contains information about federal research and education grants.

 **The newsletter is at: <http://www.ramsfie.com/opportunity.htm>. Follow the instructions given on the screen to receive a free subscription.**

**7.3 Thinking of Relocating Your Organization?** The top five states with the healthiest employees are Minnesota, Utah, Hawaii, New Hampshire, and Massachusetts, according to the financial services company, ReliaStar. The rankings are based on measures such as sickness/disability rates and health care.

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