



Nonprofit Alert®

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

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➤ Nonprofit Overview

Tax-Exempts Cautioned As Impeachment Freeze Yields to Campaign Breeze

As winter snows melt away, campaign announcements are springing up faster than daffodils. Elections induce political activism that even some tax-exempts find hard to resist. But political activity, like an unpassable snow bank, should signal caution for nonprofits.

The IRS absolutely prohibits tax-exempts from supporting or opposing any candidate for public office.

The penalty for violating the prohibition: loss of exempt status. The IRS recently revoked an organization's exemption for broadcasting a negative radio commentary about a presidential candidate who "failed" the organization's political and economic ideology test. The IRS

did not identify the organization, but described it as a tax-exempt that "routinely distributed information on public policy issues and conducted research." While that activity was permissible, the broadcast went too far, the IRS determined. "Comments on the views of a Presidential candidate which name the candidate, mention his or her candidacy...and explicitly favor or oppose the candidate's views violate the proscription against political campaign intervention," the IRS ruled. *IRS TAM 19907021*. As for lobbying, the tax code permits some leniency, allowing charities to lobby only if "no substantial part" of their overall activities is spent on influencing

legislation. But the IRS has never given the "substantial part" test a quantifiable definition. This leaves many charities uncomfortable about how much is okay. In 1976, Congress attempted to ease these concerns by enacting §501(h) of the tax code. This allows charities to spend a set percentage of their total budgets

on lobbying. However, a charity must formally elect to be covered by this provision before its protection will apply. Many charities resist making the election, thinking it'll only draw more IRS scrutiny. Not so, says IRS official, Marcus Owens. Responding to Charity Lobbying in the Public Interest (CLPI), a project of the trade group Independent Sector, Owens

Quote of the Month:

"Comments on the views of a Presidential candidate which name the candidate, mention his or her candidacy...and explicitly favor or oppose the candidate's views violate the proscription against political campaign intervention."

—IRS TAM 19907021.

wrote, "The fact that an organization has made the election is not ground(s) for an examination."

➡ **To de-winterize your nonprofit and wisely prepare for this hot season of political activity, review NP9101-3, *Nonprofit Lobbying & Political Activity*, available from Gammon & Grange. See back page to order. CLPI also offers resources to charities.**

➡ **Contact Independent Sector for details at (202) 467_6100 or via email at info@IndependentSector.org.**

~~~~~ **National Volunteer Week : April 18 - 24** ~~~~~ Visit <http://www.energizeinc.com/ideas.html> for ways to honor your dedicated volunteers. Evaluate your organization's volunteer program with Gammon & Grange's Nonprofit Alert® Memo NP9301-1, *A Prudent Volunteer Program for Nonprofits*. See back page to order copies for your organization.

## Liability & Risk Management

### Ministry Leaders Face Indictment on Fraud Charges

Last month, **Nonprofit Alert**® reported an alleged pyramid scheme being operated by the Florida-based Greater Ministries International. Now, seven leaders of the group have been indicted on 20 counts of fraud, conspiracy, and money-laundering. The grand jury indictments charge the group's president, Gerald Payne, along with his wife and several other ministry leaders with running a six-year scam that defrauded investors by promising to double their money in less than two years. The indictments didn't specify how much was lost, but the *Tampa Tribune* reports at least two ministry leaders claimed they gathered \$500 million.

➔ **A state judge in Pennsylvania also fined Greater Ministries \$6.4 million last month for violating a cease and desist order. In addition, two Alabama men have filed a civil suit against the organization, seeking return of the \$170,000 they invested.**

### Congress & States Weigh Y2K Liability Limitations

Congress is considering several bills this session to limit liability for Y2K-related claims. In the House:

- H.R. 775 limits the kind of damages allowed under a Y2K contract breach, and
- H.R. 192 requires mediation of any Y2K claim.

In the Senate, two additional bills have received attention from the business and nonprofit communities:

- S. 461 discourages litigation of Y2K claims without first attempting legitimate settlements, and
- S. 96 limits punitive damages for Y2K claims to \$250,000 or less if a defendant employs fewer than 25 full-time employees or has a net worth under \$500,000.

At least 30 state legislatures have various versions of limited liability legislation in the Y2K hopper. In Virginia, for instance, three bills have passed restricting Y2K damage suits. Six other states passed similar legislation last year.

➔ **In addition to supporting beneficial Y2K legislation, prudent nonprofits should systematically audit potential Y2K liabilities and take appropriate risk management steps. Gammon & Grange offers two tools: NP9812-1, *Defusing the Y2K Timebomb* and NP9812-2, *Y2K Checklist*. See back page to order.**

The board of trustees of an independent nonprofit school merely assessed a school director's performance when they sent a letter to parents informing them of her termination, an Illinois appeals court has ruled. The letter did not defame the director, as she claimed, because it was not a "reckless or conscious disregard for her reputation or property," the court ruled. The case arose when the school's board of trustees privately proposed organizational changes. The director copied the confidential proposal and distributed it to the faculty. When the board learned of her action, they fired her, citing a "breakdown of trust." The school then mailed a letter to parents, stating the board had "concluded [the director] was not satisfactorily performing her duties or carrying out the policies of the board." She sued for defamation, claiming the letter implied she lacked integrity. *Dunlap v. Alcuin Montessori School*, No. 1-97-0017 (Ill.App.2nd Div. 1998).

➔ **The board escaped liability in this case by restraining negative comments to a brief factual assessment. How would your organization handle this situation? For guidance, refer to NP9206-1, *Developing a Defamation Policy for Nonprofits*. See back page to order. Always consult legal counsel in any problem termination**

## Employees & Volunteers

### From Brazen to Bizarre: Termination Troubles

Terminating an employee for completely bizarre behavior does not constitute discrimination of any kind, the Tenth Circuit says. The ruling came in a case filed by the president of a feed processing plant in Utah. On at least eight occasions, the president gained unauthorized entry into the private homes of plant employees. Acting on the president's alleged admission of drug use, the corporate board requested that he attend a drug treatment center. The president complied, but after three days, the center discharged him when no chemical dependencies were found. Upon returning to work, the board terminated his employment. The president then sued, claiming discrimination because the company perpetuated the perception that he suffered an addiction. Lower courts sided with the corporation, and the Tenth Circuit affirmed, finding that the termination was based solely on the president's bizarre behavior. *Nielsen v. Moroni Feed Co.*, 1998 WL 849530 (10th Cir., 1998).

➔ **Handling problem terminations can be sensitive and time-consuming matters. Find tips in NP9102-2, *Wisely Managing Employee Terminations*. Employment actions become even more complicated when substance abuse is involved. Learn how to cope with dope NP9706-1, *Substance Abuse Prevention in the Nonprofit Workplace*. See back page to order.**

### All Work and No Play? You're Not Alone Anymore

The Families and Work Institute reports that the work week for American employees has increased over the last 20 years by 3.5 hours to an average of 47.1 hours per week. The study also found

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over one-third of American workers now bring work home with them on a regular basis. That figure has increased by 10% since 1977. And, not surprisingly, 88% of workers now say their jobs require them to work “very hard” (up by 18% since 1977).



For details of *The 1997 National Study of the Changing Workforce*, check the Institute’s web site at <http://www.familiesandworkinst.org>.

## Tax-Exempt Issues

### ***Affinity Cards: If Rightly Dealt, Royalties Flushed***

In a long-running saga over the taxability of income from affinity credit card programs, the Tax Court has again ruled that such income constitutes non-taxable royalties. The ruling came in response to a case remanded by the Ninth Circuit, which reached the same conclusion last year. Both the Tax Court and various federal Courts of Appeals have all ruled that affinity credit card programs, operated by nonprofits with passive involvement, are exempt from taxation because they produce royalties not income. However, the IRS has persisted in appealing these rulings. The IRS has not yet indicated whether it will appeal this latest decision. *Sierra Club Inc. v. Commissioner*, T.C. Memo 1999-86.

### ***Fairground Storage Makes Fair Ground for UBIT***

A tax-exempt organization operated an annual agricultural fair and owned several buildings on the fairgrounds that were routinely

used to display exhibits, etc.. During the winter months, the organization leased out space in the vacant buildings for vehicle storage. The IRS ruled that fees collected from these leases constituted taxable unrelated business income (UBIT) because the leases were totally extraneous to the organization’s exempt purpose. The IRS also considered whether the lease fees could be characterized as rental income, which would likely have been exempt from UBIT. But instead, the IRS determined the leases did not constitute any rental of real property. IRS LTR 199901002.



**Under the tax code, rent is generally not considered UBIT. But the tax regs specify that payments for the use or occupancy of parking lots, warehouses, or occupancy or storage garages do not constitute exempt rent. IRC §512(b)(3)(A) and Treas. Reg. §1.512(b)-1(c)(%).**

### ***IRS Reorganization: Expect More Web Site Scrutiny***

A long planned reorganization at the IRS will likely result in more regulatory oversight of tax-exempt organizations, IRS official Marcus Owens says. Plans call for the staff of the exempt division that Owens oversees to double in size from about 2,100 current workers to 4,000. This will enable the IRS to demand a “higher level of accuracy in completion of the [Form] 990,” Owens predicts. In addition, Owens says the division is working to update a new “plain-language” guidance publication for churches, due out sometime this year.



**Owens also expects to see greater review of nonprofit websites, especially those that contain advertisements or lobbying appeals. Brace your organization with NP9102-3, Preparing the Nonprofit for an IRS Visit. See back page to order.**

## ***NPA Highlight of the Month***

### ***Duty Doesn’t End With Supervisor . . .***

## **Laws Require Child Abuse Reporting**

Most organizations that work with children in mandatory reporting states know they have a duty to report suspected child abuse to the proper authorities, but that duty can also encompass *every employee* who works with children. Employees should be acutely aware of this personal duty, and organizations should take every effort to inform employees, lest they face the same personal liability that two Kentucky teachers recently encountered. The case arose when students told a teacher and a counselor that another teacher had engaged in sexual conduct with certain students. The counselor and teacher then individually told the school principal, but later, the state brought charges against them both for failure to report to the proper state and county authorities. A lower court dismissed the case, finding that the counselor and teacher lacked the requisite intent to violate Kentucky’s child abuse reporting laws. But on appeal, the Kentucky Supreme Court overturned the lower court’s decision, ruling that reporting to a supervisor is not a proper report pursuant to the state child abuse reporting statutes since there is no guarantee a supervisor will follow through with his or her duty by relaying the report to the proper authorities. The court said the legislature clearly intended that every individual entrusted with the care and supervision of children should have an affirmative duty to report crimes against those children. Such individuals are not relieved of this duty merely by reporting to a supervisor. *Commonwealth of Kentucky v. Allen*, No. 97-SC-713-DG (KY Sup.Ct. 1998).



**State courts in at least four other jurisdictions (Florida, Indiana, Minnesota, and Wyoming) have handed down similar rulings in recent years. All 50 states have adopted some version of child abuse reporting laws, but the specific requirements vary widely by state, including some states where certain workers are designated “mandatory reporters.” If your organization serves children in any capacity, consult local legal counsel to find out the specifics of your state’s reporting laws. Gammon & Grange’s NP9711, *Summary of State Child Abuse Laws*, also offers general help with specific state supplements. See back page to order, and specify which state(s) summary you need.**


### ***Beyond Bingo: Bill Expands Gambling Exemptions***

Sen. Rod Grams (R-MN) has introduced a bill to expand the §513(f) tax exemption by including games of chance. Presently, certain nonprofit bingo games are exempt from unrelated business income tax (UBIT). This new bill would also exempt “qualified games of chance” conducted by tax-exempt organizations so long as the games are in accordance with state law. S. 490.

 **The IRS offers help on gaming issues for nonprofits in its free Publication #3079. Request a copy at (800) TAX-FORM.**

### ***Charities Don't Invest Charitably, Report Shows***

A new study reveals that many U.S. foundations don't invest their financial assets in companies or income-producing ventures that support their own charitable values. Some even hold investments in ventures that are contradictory to their missions. The study also found that board members often don't even know what investments make up a foundation's portfolio.

 **For a free copy of *Passive, Dissonant or Making a Difference: Which Way for Foundation Investing?*, contact the Financial Markets Center at (540) 338-7754 or read the online version in the publications section at <http://www.fmcenter.org>. Also check out the free web tools on values-based investing in the money section at <http://www.crosswalk.com>.**

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## **State Rules & Regs**

### ***Maryland: Retirement Haven for Wealthy Donors?***

The state legislature is considering a capital gains tax break for wealthy resident donors to discourage them from moving outside Maryland. Two years ago, a wealthy real estate mogul left the state and established residency in Florida where the capital gains on his property holdings are not taxed. His foundation, one of the largest in Maryland, contributes annually to religious and educational nonprofits in the state, but lawmakers are concerned that others like him might depart, leaving behind a serious deficiency in charitable contributions to state nonprofits.

### ***Oregon Lobby Registration Violates Free Speech***

The state law that requires lobbyists to pay a registration fee is unconstitutional, the state supreme court has ruled. Two lobbyists for the nonprofit American Civil Liberties Union challenged the state law that required them to pay \$50 every two years as an unconstitutional violation of free speech. The court agreed, saying, “At some point, there may be so little to distinguish between the saying of a thing and the ‘profession’ of saying it that permitting a regulation on the theory that it is directed at the profession, rather than at the statement, would represent a triumph of form over substance.” *Fidanque v. Oregon Gov't Standards and Practices*, No. S43705 (OR Sup.Ct. 1998).

 **Make sure your organization's solicitation registrations are current, especially if you engage professional lobbyists or solicitors. Consult NP9103-4, *Multi-State Summary of Charitable Solicitation Laws*, for an overview of these regulations in all 50 states, plus the District of Columbia. See the box at left for ordering instructions.**

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