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Nonprofit *Alert*®

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

Inside This Nonprofit *Alert*®

LIABILITY/RISK MANAGEMENT.............**p.2**
★ Board Trustees Liable for Bad Policy
★ Beware Pirated Software
★ Y2K and Beyond for Nonprofits
EMPLOYEE/VOLUNTEERS LIABILITY.....**p.2**
★ If it looks like a Duck...
★ No Stealth Arbitration Clauses, Court Says
TAX-EXEMPT ISSUES.........................**p.3**
★ Time for Year-End Receipting
★ Tax Filing Threshold Remains
STATE RULES & REGS............................**p.4**

Plus NPA Highlight of the Month:
What to Expect at the IRS.......................p.3

Congress Finally Ends Uncertainty:

Tax Break for Stock Donations Permanent

In its last minute rush to pass a tax bill before adjourning last month, Congress finally made permanent a popular tax break for stock donations to private foundations. The provision first appeared in the tax code in 1984, but had only been available as an on-again-off-again benefit because Congress routinely let it expire, only to reinstate it in succeeding sessions. Although the break was attractive, tax planners loathed Congress' unpredict-ability. Efforts had been underway for years to make the provision permanent, but it wasn't successful until legislators included a requirement that private foundations submit to the same disclosure rules as public charities.

★ **The news gets even better: Congress also made this break retroactive to June 30, 1998, when it last expired. This break allows a charitable deduction at fair market value for gifts of "qualified appreciated stock." This means donors may deduct the stock gift at its appreciated value rather than its base value, which in the booming stock market of recent years, is a significant windfall for donors.**

Nonprofit Overview

Nonprofit Liable for Volunteer's Negligence

The Ninth Circuit has denied a rehearing to the Cult Awareness Network (CAN) in a case that effectively put CAN "out of business," according to a dissenting judge. The case began when Kathy Tonkin contacted Shirley Landa, a CAN volunteer, and requested help removing her sons from the influence of Life Tabernacle Church. Landa referred Tonkin to Rick Ross, a "deprogrammer" who Tonkin hired. During the deprogramming, Ross held Tonkin's 18-year old son for five days against his will. Later, the son filed suit against Ross and CAN on conspiracy and tort claims. The lower court held, and the Ninth Circuit affirmed, that CAN was vicariously liable for the action of its volunteer in recommending Ross. Evidence indicated that CAN controlled the appointments of its contact persons, selected them based on their commitment, reserved the right to terminate, and issued their code of conduct. *Scott v. Ross,* 140 F.3d 1275 (CA9 1998).

★ **That was enough, the court said, to implicate CAN, regardless of the contact person's volunteer status or CAN's lack of day-to-day control over her actions. "CAN functioned through its contact people," the court wrote, and thereby shouldered vicarious liability for their actions.**

This case sounds a warning for nonprofits that rely on loosely supervised volunteers. Review your volunteer program with 9301-1, *A Prudent Volunteer Program for Nonprofits.* See back page to order.

Postal Service Targeting Nonprofit Eligibility Rates

The Alliance of Nonprofit Mailers reports USPS has begun a serious crackdown on nonprofit eligibility rates. USPS is reportedly examining nonprofit mail for violations of nonprofit eligibility restrictions, such as advertisement enclosures or merchandise offers. Meanwhile, rate increases take effect Jan. 10.

★ **Gammon & Grange is representing a religious nonprofit in bringing statutory and constitutional challenges against the USPS for its restrictions on religious utilitarian items that USPS says aren't substantially related to an exempt purpose.**

Carefully review any holiday mailings that could trigger inspections. Then check http://www.nonprofitmailers.org for more information on rates.

Liability & Risk Management

Board Trustees Liable For Preferential Contracting

A federal judge has held the entire board of trustees for Cuyahoga Community College personally liable for damages stemming from a decision they made in 1996 to enforce a constitutionally illegal minority set-aside policy on contractors. Such policies have been unconstitutional since a 1995 Supreme Court case said they had to be narrowly tailored with special regard for past discrimination. The judge found that no such regard was given in this case, citing minutes from a board meeting in which a lawyer explained the Supreme Court precedent to the trustees, but the trustees failed to correct their policy. *F. Buddie Contracting, Ltd. v. Cuyahoga Community College District*, No. 196CV2136 (N.Dist.OH, 10/21/98).

★ **While the set-aside issue doesn't affect most nonprofits, what is most compelling about this case is the board's blatant disregard for legal precedent, and "abdication of their decision-making obligations," as the court said, which was then preserved in their board minutes.**

The lesson is obvious: urge your board to make timely and proactive policy decisions whenever legal, administrative, or managerial developments make old policies unworkable or unacceptable. Only a very compelling reason can justify ignoring or rejecting the advice of professional counsel.

"Fair Share" Policies Draw Negative Attention

At least three employees of Colonial BancGroup, Inc. have lost their jobs after refusing to participate in the corporation's mandatory giving program to United Way. Charity officials worry the media attention on the firings creates negative publicity for United Way. Colonial enforces a "fair share" program that requires employees to donate at least one hour's pay per month to United Way. Although the charity does not recommend mandatory giving programs, it maintains many corporate relationships.

★ **United Way officials say they discourage corporate employers from making inappropriate solicitation requests of employees. Many local United Way chapters have even adopted policies saying they will return gifts from employees if they complain that employers pressured them into giving.**

Nonprofit *Alert*®
8280 Greensboro Drive, 7th Floor, McLean, VA 22102-3807
(703) 761-5000 Facsimile: (703) 761-5023
E-mail: npa@gandglaw.com
Editor-in-Chief .... *George R. Grange, II*
Editor .... *Sarah J. Schmidt*
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New Warning: Alliance Tracks Pirated Software

What may seem innocent enough when a staff member borrows software from the office to load on a home computer may land your organization in hot water if the Business Software Alliance gets involved. The Alliance represents eight leading software vendors, including Microsoft and Lotus. It investigates cases of software and networked applications piracy for potential legal challenges by the vendors. Many investigations begin with tips from disgruntled former or current employees who suspect or know of particular wrongdoing. The Alliance operates a tip line with operators trained to ask questions about proper licensing and use applications. So far, the Alliance has primarily targeted large corporations, but with the proliferation of networked technologies, the scope of its scrutiny has widened considerably.

★ **Nonprofits are particularly susceptible to these violations. Even if your organization holds a volume license for a piece of software, you could be at risk if you install more copies than your license allows, or allow such software to be installed on unlicenced home PC's.**

As a risk prevention tool, implement an annual review of all software and network licenses your organization holds. Make sure you're operating in compliance with their specifications.

Y2K and Beyond: What It Means for Nonprofits

There's a lot of hype these days about the Y2K problem, but from a legal perspective, there are indeed some serious issues for nonprofits to consider. Chief among the concerns are:

- Compliance Issues: everything from an organization's internal controls to its external verification processes can be affected.
- Mission-Critical Aspects: organizations should confirm whether their suppliers, vendors, and any other third parties they rely on for continuous operations are Y2K compliant.
- D&O Liability: directors and officers could be personally liable, along with the organization, for internal Y2K problems.

Two new Nonprofit Alert Memos help address these issues in greater detail. NP9812-1, *Defusing the Y2K Timebomb,* outlines the risks for nonprofits. NP9812-2, *Y2K Compliance Checklist,* provides a sample survey to use in determining appropriate actions, including sample supplier letters and contract clauses. **See back page to order both.**

Employees & Volunteers

If It Looks Like a Duck and Quacks Like a Duck...

then it must be a duck, right? Not so with FMLA leave, says the Sixth Circuit. When a female employee sued her employer, a medical equipment company in Ohio, for violating the Family & Medical Leave Act (FMLA), the Sixth Circuit refused to hear her appeal because the company didn't meet the FMLA definition of "employer." It employed only 24 workers at the facility where plaintiff worked, far short of the 50 required for coverage by FMLA. The court said employees at that facility were not covered by FMLA, although company workers at another facility

with the requisite number were covered. *Douglas v. E.G. Baldwin & Assoc.,* 150 F.3d 604 (CA6 1998).

★ **The company also published the specific terms of its FMLA leave and its availability to all company employees. However, the court said that merely offering a benefit and calling it "FMLA leave" did not create liability for the company because it wasn't subject to FMLA in the first place (although it could raise potential contract questions regarding the employment agreement itself).**

This court was unusually generous, since many courts hold employers liable for commitments like these. Not every FMLA case is so favorable to employers; read why in NP9407-1, *All in the Family—Living With FMLA*. See back page to order.

No Arbitration Unless Employee Knowingly Agrees

In what seems like an obvious conclusion, the Ninth Circuit says an arbitration agreement cannot be effective unless both parties knowingly accept it. When William Kummetz went to work for Tech Mold, Inc., the company gave him an "Employee Information Booklet" and an "Information Booklet Acknowledgment," which he signed. But the acknowledgment contained no mention of an arbitration agreement in the booklet or elsewhere. Later, employment problems, arose and Kummetz filed a disability suit against the company. A lower court dismissed the case, finding that he waived his right to trial by agreeing to arbitration in the "Employee Information Booklet." But the Ninth Circuit ruled the arbitration agreement was never presented to nor explicitly acknowledged by Kummetz. *Kummetz v. Tech Mold, Inc.*, 1998 WL 480900 (CA9 1998).

★ **If your organization imposes arbitration, make sure it's clearly written and signed by each employee. The mere presence of an arbitration clause somewhere in an official document does not necessarily make it legally binding.**

Consider the benefits arbitration could hold for your organization with NP9510-1, *Alternate Dispute Resolution: Arbitrate , Don't Litigate.*

Tax-Exempt Issues

It's That Time Again: Year-End Receipting Beckons

Along with the holidays, December usually brings a year-end rush to provide donors with the ever critical receipts they must have to claim charitable tax deductions. Charities aren't required to issue such receipts, but most do as a courtesy. A recent case shows why: John and Donna Dorris were denied nearly $35,000 in charitable deductions because the checks they gave to a social ministry were blank. Some of the checks had even been deposited into an account managed by a corporation owned by their minister. The court said these were obviously not for the ministry's exempt purposes, so those deductions were denied. *John Andrew Dorris v. Commissioner*, T.C. Memo 1998-324.

★ **Tax laws require donors to substantiate contributions of $250 or more with written acknowledgments, not just**

NPA Highlight of the Month

Where Do We Go From Here?

IRS Hints at Future Developments

Speaking on various occasions in recent months, IRS and Treasury officials have forecast potential congressional developments and agency plans for tax-exempt organizations. Among the topics were:

Treasury Deputy Tax Counsel Steven D. Arkin predicts Congress is "virtually certain" to consider legislation in 1999 that will revise the "control test." The test determines when an exempt organization actually "controls" a for-profit subsidiary and is thereby liable for taxes. A 1997 law lowered from 80% to 50% the ownership floor for control, but Arkin says Congress may consider replacing the percentage requirement with a fair market standard.

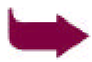
Marcus Owens, head of the IRS Exempt Organizations Division, has repeatedly warned that agents are focusing on UBIT from travel tours offered by exempt groups. Now, the IRS has announced a public hearing on the issue, Feb. 10, 1999.

Chief of the IRS EO Branch, Marvin Friedlander told a recent meeting of the D.C. Bar that the IRS was "really concerned" with charities that inflate the value of gifts so donors can claim bigger tax deductions. Tax laws impose a penalty on anyone who "organizes and sells" abusive tax shelters to reduce or defer taxes. Friedlander said the IRS could use these laws to penalize charities that purposefully inflate the value of gifts, although no such enforcement has occurred against charities to date. And finally, don't hold your breath for intermediate sanctions regulations! Owens says the IRS probably won't finalize the proposed regs it issued this past August until the year 2000. In the meantime, the proposed regs serve as interim guidance.

★ **Although none of these comments represents definitive commitments by the IRS, they do provide valuable insight about the direction of IRS plans and strategy—something exempt organizations are wise to recognize and consider when devising their own plans and strategies for the future.**

Nonprofit Alert Memos offer helpful guidance on these issues: NP9304-1, *Organizing the Nonprofit and Its Subsidiaries* discusses the "control test." NP9110-1, *A UBIT Primer for Nonprofits,"* contains helpful tips on UBIT-producing activities. NP9608-1, *Avoiding the Snares of Intermediate Sanctions* covers current and proposed regs. See back page to order. For information about the IRS hearing on travel tours, contact LaNita VanDyke at the IRS, (202) 622-7190.

canceled checks. Therefore, most donors rely on year-end receipts from charities to aid during tax preparations.



Is your receipting process operating effectively? It's one sure-fire thing donors expect. For help, turn to NP9505-1, *Demystifying the Receipting of Charitable Gifts*. See back page to order.

Critics Prevail; No Change in Tax Filing Threshold

The IRS has abandoned plans to change the filing threshold for annual Form 990s. Earlier this year, the IRS considered increasing the threshold, but the response from the nonprofit sector was lukewarm. The change would have effectively lifted the filing requirement and reduced paperwork burdens for thousands of small charities (churches are already exempt). But critics complained too many exempt organizations would then escape public scrutiny, so the IRS backed off the proposal.

State Rules & Regs

North Carolina Raises Charitable Gift Tax Credit

Gov. James Hunt (D) has signed into law a bill that raises the state tax credit for taxpayers who make charitable contributions but choose the standard deduction on their federal tax forms. The state credit goes up to 7% from 2.75%. It takes effect with the 1999 tax year. NC HB 20.

Ohio Denies Tax Exemption to Church Parking Lot

A church parking lot would ordinarily qualify for a property tax exemption under state law, but the Ohio Board of Tax Appeals has denied the exemption to a church that rented spaces in its parking lot. The Board said the church operated the lot like a commercial enterprise, which could not qualify as exempt. *Board of Education v. Tracy*, No. 97-J-285 (1998).

★ **The problem here stemmed from the church's regular rental operation of the parking lot. Occasional rentals, such as for an annual craft fair or football game, might not present the same issues, but the outcome depends on state law. Check with counsel before entering any rental deals.**

Oregon Camp Residence Escapes Property Taxes

A caretaker's residence at a religious youth camp is exempt from property tax as a charitable organization, the Oregon Tax Court has ruled, because it is necessary to the operation of the camp. The tax assessor had argued the residence was used primarily for the personal benefit of the caretaker, but the court said an on-site caretaker was necessary due to the camp's remote location. *Archdiocese of Portland in Oregon v. Department of Revenue,* No. 4114 (10/5/98).

Quote of the Month. "We want to see the facts, see the written evidence, the contemporaneous written evidence of how the organization decides to spend its money." — Marcus Owens, Chief of the IRS Exempt Organizations Branch, commenting on ways the IRS intends to enforce intermediate sanctions. For more information, see *NPA Highlight*, p. 3.

This underscores the three guiding rules of sound HR practice: document; document; document.

Looking for the Perfect Stocking Stuffer? New this Christmas is the Colin Powell action figure, by Hasbro. The figure sells for $49.99, with a portion of the proceeds benefiting the Boys & Girls Clubs, a charity that Powell supported since retiring as Chairman of the Joint Chiefs.

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Richard M. Campanelli
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