



Nonprofit Alert®

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

1. Nonprofit Overview

1.1 Congress Passes Charitable Donation Protection Act.

New legislation, passed unanimously by both houses of Congress last month, now prevents creditors from suing charities for contributions given by bankrupt donors. It also permits bankrupt donors to tithe and make other charitable contributions after they declare bankruptcy. Titled the Religious Liberty and Charitable Donation Protection Act (H.R. 2604), the measure is aimed at correcting a controversial 1992 court decision that forced a Minnesota church to return thousands of dollars in weekly tithes from a couple who declared bankruptcy. (NPA, May '98). Lawmakers' indicated their dissatisfaction with that court ruling by giving this legislation widespread bipartisan support. At press time, the act is awaiting President Clinton's signature, but the administration has already signaled its support of the legislation. Two features in the act are notable:

- A special provision makes it applicable to any bankruptcy case currently in litigation. Supporters say this is intended to stop the avalanche of bankruptcy claims being filed against churches and other charities in the wake of the Minnesota case.
- Individuals who file Chapter 13 bankruptcy are allowed to continue making charitable contributions up to 15% of their annual income. Some individuals could be allowed even more if they show a consistent practice of giving.

★ **Nonprofit and Congressional leaders alike hailed this legislation as long overdue. The act constitutes a major step in eliminating the perverse application of fraudulent conveyance laws seen in the Minnesota case, but it has limited impact on situations where corporate donors engage in fraudulent and extensive patterns of charitable grant-making.**

1.2 Nonprofit Postal Rates On the Rise Again. The Postal Rate Commission has recommended an average increase in nonprofit postage rates of 9.6%, with nonprofit periodicals increasing by 8%. The Postal Service had requested substantially higher increases (as much as 11.3% for some mail pieces), but the Rate Commission scaled back the percentage for letters and increased the percentage for periodicals. Many nonprofit groups have taken issue with the Commission's calculations, claiming that the Postal Service's request was based on outdated cost figures that don't reflect savings from a new mail classification

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system adopted in 1996. Edward Gleiman, Commission chairman, admitted he was "not comfortable with the nonprofit cost data."

★ **Gleiman also questioned why the Postal Service requested an increase at all this year, after reporting more than \$1-billion in budget surpluses for the last three years. That doesn't include \$285-million in better-than-expected earnings from the first quarter of 1998 that Postmaster General Marvin Runyon reported in April.**



Some nonprofits say they may seek relief from Congress. Contact the Alliance of Nonprofit Mailers, (202) 462-5132 for help, or visit their web site at: <http://www.nonprofitmailers.org>.

1.3 Affiliate of National Charity Keeps \$1M. The former Mississippi state affiliate of the American Diabetes Association may keep ownership of approximately \$1-million in funds, plus records, membership lists and other assets, after a federal judge ruled against the national organization in a controversial opinion last month. The Diabetes Association attempted to merge its 53 state and local units into one national organization to save administrative costs, but state affiliates in Mississippi and Rhode Island refused to relinquish their assets, claiming they would lose donations if they merged. The Mississippi affiliate has now reorganized as an independent charity called the Diabetes Foundation of Mississippi. The Rhode Island affiliate is still fighting the move.

★ **Although this ruling gives the Mississippi affiliate its assets, the judge ordered the affiliate to honor its original contract, which means it owes a percentage of its charitable receipts to the national organization through June 30, 1998.**

2. Liability & Risk Management

2.1 Knowledge Isn't Everything When Tax At Issue.

Although a vice president had knowledge of a corporation's tax improprieties, the Court of Federal Claims says he is without fault because the corporate president exercised final approval on all accounts payable. When the corporation paid insufficient payroll taxes, the IRS brought suit against the vice president as a "responsible person." But he only signed checks in the president's absence or in emergencies. He had no control over the issuance of checks with signatures other than his own. The president controlled all funds and signed all checks, except for two that the vice president signed during the tax years in question. *DeAlto v. U.S.*, Ct. Fed. Cl. (5/13/98).

★ **The "responsible person" penalty under the tax code saddles all nonprofit executives with personal liability for a 100% penalty on employment taxes their organization fails to withhold. The test does not depend on formal title or position, but on one's ultimate authority to dispense funds. Some courts have also held that anyone with check-signing authority can be responsible, regardless of whether their failure to pay taxes comes at the instruction of a superior.**

2.2 Employer May Be Liable for "Peeping Tom". A Virginia court has allowed a case to go forward that accuses an employer of liability for an employee who allegedly caused two co-workers emotional distress when he spied on them in the bathroom. In most instances, such activity would be considered "outside the scope of employment" (i.e. the test for determining whether an employer is liable for an employee's actions under the legal theory of respondeat superior). But in this case, the court said the employee's actions did not deviate enough from his assigned job duties to definitively take him outside the scope of employment. The employee worked as a bagger at a grocery store. His supervisor instructed him to remove trash and other debris from above the ceiling of the men's bathroom. Since the two restrooms were adjacent, the employee was actually in the space where he was instructed to be when the alleged wrongdoing occurred. *Shifflett v. Food Lion Inc.*, VLW

098-8-138, (Va. Cir. Ct. 1998).

➡ **Practitioners note a judicial trend expanding respondeat superior, making all employers—including nonprofits—liable for more employee activities. Understand the implications with NP9402-1, *Minimizing Liability through Responsible Hiring & Supervision*. See back page to order.**

2.3 Once Is Enough for Alcohol Treatment. The First Circuit has ruled an employer doesn't have to offer help beyond its initial attempt at substance abuse treatment for employees. The case arose from a disability discrimination suit filed by a Federal Express employee who lost his job for excessive absenteeism. He claimed his absences should have been accommodated because they were caused by alcoholism, which is a disability under the Americans With Disabilities Act. But Federal Express showed that the employee had already undergone four weeks of substance abuse treatment at the company's expense and was ineligible to take additional leave for alcoholism. Employment records also indicated that Federal Express gave the employee repeated warnings about his absenteeism, including counseling by his supervisor.

★ **The court noted that EEOC guidance doesn't specifically require employers to provide substance abuse treatment, only to accommodate employees who elect such treatment. But accommodation doesn't mean an automatic leave of absence, and certainly not absences for a "succession of doubtful treatment efforts," the court said. *Evans v. Federal Express Corp.*, 1998 WL 3263 (1st Cir. 1998).**

➡ **Although a leave of absence may not be required for employees with substance abuse problems, federal law imposes other responsibilities on employers. Know what applies to your organization with NP9706-1, *Substance Abuse Prevention in the Nonprofit Workplace*. See back page to order.**

3. Employees & Volunteers

3.1 Doctor's Orders: Go to Work! An employer can reasonably rely on a doctor's medical certification when determining whether to grant an employee leave for medical conditions, a California court has decided. The case involved an employee who claimed he suffered from chronic fatigue syndrome. When he requested a leave of absence, his employer agreed, but asked him to provide certification from his doctor. The doctor wrote a medical opinion explaining that the employee had a chronic health condition, but advised the employee not to take any leave, saying the condition did not incapacitate him significantly. Nevertheless, the employee was absent 12 days over a period of four weeks, which violated the company's attendance policy. When he was fired, he claimed his absences were protected under FMLA. *Stoops v. One Call Communications, Inc.*, 1998 WL 142297 (7th Cir. 1998).

★ **The court said an employer is obligated to determine whether an employee's leave qualifies for FMLA coverage, but in this case, the employer could reasonably rely on the medical statement provided by the employee's own doctor.**

➡ **Self assess your compliance with NP9407-1, "All in the Family—Living with the Family & Medical Leave Act." See back page to order.**

3.2 Volunteerism Higher in U.S. Than Most Countries. At least 50% of all Americans say they do some sort of volunteer work, as compared with only 11% in Japan,

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reports a new survey commissioned by Lions Club International. The survey looked at the seven most populated countries and found volunteerism rates vary widely. India was second to the U.S. with 32%; Brazil was third with 26%; next was France (19%), Germany (17%), and Hong Kong (12%).



Free summaries of the survey are available from Janet McMahan, Lions Club International, (630) 571-5466, ext. 371.

4. Tax-Exempt News & Issues

4.1 Adopt-A-Pet Neutered by IRS. The IRS has revoked the exempt status of the Adopt-A-Pet organization because of its ties to Direct Response Consulting Services fundraising firm, formally called the Watson & Hughey Company. Earlier this year, the U.S. Tax Court upheld revocation of United Cancer Council's exempt status for a similar relationship with Watson & Hughey. (*NPA*, Jan. '98). Both groups met trouble for giving the fundraising firm complete control of their mailing lists. The IRS claims Watson & Hughey became charity "insiders" because they controlled the charity's finances. As insiders, they improperly benefited from the fundraising arrangements, in violation of private inurement and intermediate sanctions rules.

★ **Adopt-A-Pet is challenging the revocation and an assessment of \$186,844 in back taxes. Representatives say other fundraisers had similar contracts at the time Adopt-A-**

Pet contracted with Watson & Hughey in 1985.



With Adopt-A-Pet and United Cancer Council, the IRS clearly intends application of intermediate sanctions to third party "insiders." Read about the implications with NP9608-1, *Avoiding the Snares of Intermediate Sanctions*. See back page to order.

4.2 Leases Okay, But Storage Produces UBIT. In two letter rulings, the IRS addressed rental UBIT cases. The first involved a regional resource building operated by a 501(c)(3). The building housed a transportation and economic resource center, maintained by the 501(c)(3), but 85% of the space was rented to other nonprofit groups. The IRS ruled that operation of the building contributed to the 501(c)(3)'s exempt purpose because it contained the resource center and other related nonprofits. As such, it did not produce unrelated business income (UBI). In the second ruling, however, the IRS decided that rental income, produced by a temporary storage facility that was owned by a 501(c)(3), was taxable as UBI because a majority of the facility was open to the general public. The 501(c)(3) provided low-income housing to needy families, many of whom also had storage needs. But only about 2% of the storage facility was used by the families. The IRS said this wasn't enough to support of the charity's exempt purpose. IRS LTRS 9810038 & 9821067.

To minimize UBIT when managing revenue sources, refer to NP9110-1, *A UBIT Primer for Nonprofits*. See back page to order.

5. State Rules & Regs

5.1 Indiana Grants Exemption for Church Renovation.

A church may claim a property tax exemption for a building that was undergoing renovation on the date of a tax assessment, the Indiana Tax Court has ruled. State tax assessors had claimed the building didn't qualify because it wasn't being used exclusively for church purposes at the time. *Trinity Episcopal Church, et. al. V. State Board of Tax Commissioners*, No. 49T10-9610-TA-00143 (5/1/98).

NPA Highlight of the Month

Citing Focus on Youth,

Colin Powell Challenges Nonprofit Associations

General Colin Powell urges the nation's nonprofits and trade associations to take responsibility for America's youth. The challenge is finding ways to partner with corporations and other nonprofits for services that make a difference in children's lives. "We either build our children, or we keep building jails," Powell warned nonprofit leaders at a recent conference sponsored by the American Society of Association Executives (ASAE) in Washington. "It's time to stop building jails and start building children," Powell urged conference attendees. David Parker, ASAE Board Chairman, pledged ASAE's partnership with America's Promise, the nonprofit headed by Powell and dedicated to helping the nation's youth. ASAE plans to sponsor "Job Shadow Day" next February 2, during which ASAE members take students to work and introduce them to opportunities in the workplace. The event is similar to the popular "Take Your Child to Work Day," but ASAE encourages members to take children besides their own who might not otherwise have a mentoring experience. Even nonprofits that don't directly serve children can find ways to offer help through programs like job shadowing, Powell believes.

★ **Powell points to the American Trucking Association as one example. Through a partnership program with local schools, truckers relay information about their travels to classrooms via the Internet, then stop by for a visit when they're in town. "Students get a geography lesson from truckers who've actually seen most of the places they're studying," Powell said.**



For more information on ASAE's "Job Shadow Day" and details on how your organization can participate, contact Paul Meyer at ASAE's Government Affairs Office, (202) 626-2704, or call the Job Shadow office at (800) 251-7236. Visit their official web site at: www.jobshadow.org.

5.2 Michigan Study Shows Reluctance to Bequeath.

Only 38% of Michigan residents have a will, and of those, only 15% include a financial bequest to charity, according to a study by Michigan State University. That equates to only 6% of all Michigan adults over the age of 18, researchers say.

★ **If those numbers are indicative of the whole U.S. population, as researchers believe, this means the field is ripe for charities to educate donors about the benefits of bequeathing gifts through wills and other testamentary devices.**



For a free copy of the survey, contact Associate Professor Mark Wilson, (517) 355-6672, ext. 114, email: wilsonmm@pilot.msu.edu.

6. Gifts & Fundraising

6.1 Brokerage Firm Pays Royalties to Nonprofits.

A San Francisco brokerage firm has figured out a no-risk way for nonprofits to benefit from the burgeoning stock market trades. Trades placed with Thomas F. White & Co. generate a \$10 royalty payment to nonprofits whenever buyers specify a nonprofit they support. Mutual fund purchases generate slightly larger royalties. The brokerage firm takes its regular commission on the trades, but forwards the royalties to participating nonprofits. The program first began six months ago and is open to nonprofits of all kinds.

★ **The program doesn't generate UBIT, Michael Bolgatz, a company spokesman says, because the payouts are royalties and the nonprofits don't engage in any business activity.**

The brokerage firm handles the entire transaction.



For more information, contact Michael Bolgatz at Thomas F. White & Co., (888) 386-3729.

6.2 Two Indicators Show Donations on the Rise.

Charitable giving in the U.S. continues at a healthy rate, according to two sets of recently released statistics. The

Combined Federal Campaign, the annual charity drive conducted among all federal workers, announced it collected \$197.1-million in 1997, an increase of \$3.5 million over 1996 collections. A second indicator released by *Giving USA*, an annual trade report, showed charitable donations up overall by 7.5%. The largest increases in donations went to international groups (12.45%) and educational institutions (9.75%).



Experts agree the strong stock market accounts for most of the increases. Is your organization taking advantage of the healthy economy by soliciting non-cash gifts, such as stocks and bonds? Read NP9109-6, *Gifts of Property*, to review the options.

7. Items of Executive Interest

7.1 Quote of the Month. "Giving to others is a virtue that children should learn in their early years so they take it into their adult lives." — Ret. Gen. Colin Powell, speaking at the annual ASAE Legislative Affairs Summit, Washington, D.C.

7.2 Tax Code v. Bible: Words Apart. The U.S. tax code contains some 1.3 million words. That's more than the Bible and *War and Peace* combined, notes a House Ways and Means Committee report. The Bible contains 774,746 words. *War and Peace* has 660,000.

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