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Nonprofit Alert®

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

Inside This Issue:

Charities Lose Key Issues in New Tax Law

The tax law recently signed by President Bush may be hailed as the most sweeping tax change in decades, but it does little to help charities. Practically every issue of importance to charities in the original legislation ended up on the cutting room floor by the time the final bill was signed into law. In one case—estate tax repeal—the law will likely even deter charitable gifts.

Estate Tax Repeal

The Treasury Department predicts charities will lose $5-$6 billion in annual charitable bequests due to repeal of the estate tax, since many charitable gifts are made as a means of reducing estate taxes.

It could have been worse, though, if Congress had made the repeal effective immediately. Instead, the taxable threshold for estates increases incrementally over the next ten years until it's completely repealed in 2010. But the repeal lasts only one year unless Congress reauthorizes the legislation in forthcoming years.

Lost Tax Breaks

At least three major tax breaks that charities had championed were deleted from the final legislation, including the much touted provision to allow non-itemizing taxpayers to take charitable deductions.

That provision would have generated an estimated $15 billion in increased donations to charities, according to a PricewaterhouseCoopers Study.

Two other pro-charity proposals were also deleted: a provision that would have allowed taxpayers to donate money from their IRAs directly to charity, and a provision that would have increasedthe annual cap on corporate charity contributions.

Community Solutions Act

Attention turns now to President Bush's Community Solutions Act, which combines some of these lost tax initiatives with the widely publicized faith-based initiatives legislation. Passage of the bill is not expected this year, however.

Florida Solicitation Law Faces Another Legal Challenge

A group of charity coalitions has filed a federal lawsuit against Pinellas County, Florida, claiming that a local law unconstitutionally requires charities to register before soliciting.

The current ordinance requires both charities and their professional fundraisers to register and pay an annual fee before conducting any kind of solicitation in Pinellas County, including Internet solicitations. Charities must also disclose details about their finances, clients, officers, and fundraising practices.

The coalition claims the ordinance is too broad because it covers Internet solicitations by groups that have no connection with the county.

The group filed a similar lawsuit in 1997, which did not address the Internet issue, but that case is still pending in federal court. (*NPA*, Nov.'97).

➔➔➔*Outcome Measurement: How to Track Success* ←←←

How are we doing? With more competition for funding dollars and more public scrutiny of programs, nonprofits are quickly turning to methods of outcome measurement for answers to that question. A new report reviews how nonprofits measure the impact of their work. It looks at several measurement examples and identifies commonalties. Find an executive summary at http://www.independentsector.org/programs/research/outcomes.pdf.

Liability & Risk Management

Picture Worth 1,000 Words . . . and Privacy Rights

A California court has ruled that members of a Little League team and their assistant coaches may proceed with an invasion of privacy claim against Time Warner, Inc., for publishing a team picture that linked them with a convicted child molester. The picture ran in *Sports Illustrated* as part of a cover story about child molestation in youth sports. The article described the case of Norman Watson, who was convicted of molestation when he was a Little League coach. An accompanying photograph showed Watson with team members and assistant coaches. HBO later broadcast a related report and used the same photograph. As owner/publisher of *Sports Illustrated* and HBO, Time Warner asked the court to dismiss the case because the photograph was a matter of legitimate public concern in which the plaintiffs could not argue any privacy rights. The court disagreed, finding that plaintiffs' identities had not previously been revealed before the photograph was published and/or broadcast. The court said the subject of the story (*i.e.* child molestation) was clearly a topic of legitimate public concern, but plaintiffs' identities were not adequately protected, although they could easily have been by merely obscuring their faces in the photograph. *M.G. v. Time Warner, Inc.*, 2001 WL 577002 (Cal.Ct.App. 5/30/01).

If your organization uses photos for marketing or any other purpose, secure release forms from all those pictured (including parents of minors). If the photo is in any way controversial, consider altering it so the identities of those pictured are properly protected.

Executive's $100,000 Loan Raises Legal Questions

The executive director of a New York childrens' charity has admitted she borrowed $115,800 from the charity to renovate her home, according to the state attorney general's office. The director also claimed that other employees borrowed thousands of dollars from the charity, despite a state law that prohibits nonprofits from making such loans. These revelations set off an in-depth investigation of Hale House Center, a childrens' shelter located in Harlem. Financial records show the center received $8.9 million in funding last year, but spent only $3.9 million on program-related services. Since 1992, the center has raised more than $43 million. Currently, the center cares for 16 abandoned or orphaned children whose mothers are either in prison or suffering from AIDS or drug addiction. The attorney general named a new interim board to supervise the charity during the ongoing investigation. One of the board's first acts was to fire the executive director.

In addition to the state investigation of these insider transactions, Intermediate Sanctions penalty excise taxes could be imposed on the charity's directors and executive director if the IRS gets involved. Read Nonprofit Alert® Memo, *Intermediate Sanctions Law,* for a better understanding of how those taxes apply.

Employees & Volunteers

Bad Case of Flu Makes Bad Case Law for Employers

The cold and flu season is still months away, but a recent decision by the Fourth Circuit Court of Appeals may have employers feeling sick right now. The court has ruled that a bad case of the flu, which caused an employee to miss four days of work and see a doctor twice for treatment, qualifies as "a serious health condition" under the Family and Medical Leave Act (FMLA). The court said the employer should have granted the employee unpaid leave for her absence rather than fire her. The court also awarded back pay. Two conflicting regulations led to the ruling. Under FMLA, an eligible employee may take unpaid leave for "a serious health condition," defined as an illness that requires "continuing treatment." Federal regulations say the flu and common cold are ordinarily not "serious health conditions." However, additional regulations specify that "continuing treatment" under FMLA includes more than three consecutive calendar days of incapacity and medical treatment at least two times during that period. Because the employee met those criteria, the court determined that she qualified for FMLA coverage. FMLA "focuses on the effect of an illness on the employee and the extent of necessary treatment rather than on the particular diagnosis," the court explained. *Miller v. AT&T*, No. 00-1277 (4th Cir., 5/7/01).

Legislative efforts to more narrowly define "serious health condition" are now underway with the introduction of S.489, in addition to a Department of Labor review for technical corrections to the FMLA. Understand more about the intricacies of this federal law by reading Nonprofit Alert® Memo, *FMLA Compliance.* See back page to order copies for your human resource professionals.

Eavesdropping on Employees Now Common Practice

A startling 77.7% of U.S. corporations now monitor their employees' communications on the job, including Internet and email usage, according to a recently released study by the American Management Association (AMA). That percentage has doubled since 1997, when the study was first conducted. The survey covered all types of entities, including nonprofit,

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governmental and for-profit organizations. Of the nonprofit groups surveyed, between 70-80% reported they actively monitor employee communications on the Internet and telephone. The primary reasons organizations said they monitor employees are concerns regarding legal compliance and risk management, productivity, performance, and security. Of those companies that conduct monitoring practices, 88% inform their employees of the policy in advance.

Does your organization monitor employee communications? Many legal experts predict routine monitoring will soon become a standard practice in supervising employees. Find a full summary of the AMA report at http://www.amanet.org.

Tax-Exempt Issues

To Company's Film Donation, IRS Yells "Cut!"

The IRS has ruled that a broadcasting company's film library has no value, and has denied the company a charitable deduction for its contribution of the library to a public charity. The IRS determined that the film library, consisting of numerous pieces of local news footage, constituted a corporate asset because it served as a collection of company information. The footage was never included in the company's inventory nor offered for sale to the public. The company claimed charitable deductions in amounts equal to the fair market value of the footage, but the IRS rejected this valuation. Under §1221(3) of the tax code, letters and memoranda, copyrights, and literary, musical, and artistic compositions, or similar property are excluded from the definition of a capital asset if they are held either by a taxpayer who created the items, or for whom the items were created, or in whose hands the basis of the property is determined during a sale or exchange. In this case, the IRS likened the film library to letters or memoranda since the material was a corporate archive of items that had been produced for the company. This meant the film library could not be considered a capital asset. Instead, the IRS characterized the library as ordinary income property which, when donated to charity, produces only a deduction equal to the

NPA Highlight of the Month

Discrimination Over Contraceptives? Check Your Health Plan

A politically charged ruling by a federal judge in Seattle last month should prompt nonprofit employers to review their health insurance plans for discriminatory coverage. The ruling said health plans that do not cover contraceptives discriminate against women in violation of Title VII of the Civil Rights Act and the Pregnancy Discrimination Act. The court ordered Bartell Drug Co. to cover each of the available options for prescription contraception to the same extent, and on the same terms, that its health plan covers other drugs, devices, and preventative care, including coverage for contraception_related services, such as doctor visits or outpatient care.

"Title VII does not require employers to offer any particular type or category of benefit. However, when an employer decides to offer a prescription plan covering everything except a few specifically excluded drugs and devices, it has a legal obligation to make sure that the resulting plan does not discriminate based on sex_based characteristics and that it provides equally comprehensive coverage for both sexes," the court wrote.

Although the court found that Bartell exhibited no bad faith or malice toward women when it adopted its health insurance plan, that fact did not relieve the company of liability. "Where a benefit plan is discriminatory on its face, no inquiry into subjective intent is necessary," the court said in a statement that is sure to raise more questions. The court went on to conclude that, "Title VII requires employers to recognize the differences between the sexes and provide equally comprehensive coverage, even if that means providing additional benefits to cover women_only expenses." *Erickson v. Bartell Drug Co.*, No. C00_1213L (W.Dist.WA, U.S.D.C., 6/12/01).

This ruling marked the first federal court decision on the issue of contraceptive coverage. However, an EEOC opinion issued last year reached the same result. In that case, the EEOC said a company's health plan was discriminatory because it covered prescription drugs like Viagra and other forms of contraception, including vasectomies, but not prescription contraceptives like birth control pills. EEOC Op. 12/14/01. Viagra was not at issue in *Bartell*, since the company's plan excluded coverage for that particular prescription drug. But the court opined in a short footnote that this exclusion may, in fact, violate male employee's rights under Title VII.

Title VII only applies to employers with fifteen or more employees. But a bill (S. 104) currently under consideration by the Senate Committee on Health, Education & Labor would require all group health plans and insurance providers to include prescription contraceptives in their group benefit plans, regardless of the number of workers employed. Watch for more developments as this issue is debated in coming months.

taxpayer's basis in the property. Because the broadcasting basis in the library amounted to zero, the IRS concluded the company was unable to claim anything as a charitable deduction. IRS TAM 200119005.

International Grant Making Goes Streamlined

The IRS has advised that private foundations are not required to make an initial determination of an international grantee's charitable status using a procedure known as "equivalency determination." A private foundation may treat a foreign organization as a non_charity from the outset of its grant making processes. Previously, some practitioners thought the IRS required foundations to prove that every potential international grantee met the same standards for charity status that U.S. charities must meet. Such proof would require extensive documentation verifying that the grantee was the equivalent of a U.S. charity, including financial and organizational documents and reviews of applicable foreign laws. The IRS has now clarified that private foundations do not have to make such "equivalency determinations" of potential foreign grantees. Private foundations need only make "expenditure responsibility" reviews in which they collect accounting records from the grantees showing how the foundation grants will be used for charitable purposes.

This policy should help streamline many private foundations' international grant making processes. Even so, private foundations must be careful to exercise expenditure responsibility where grants to foreign entities are concerned.

State Rules & Regs

States Treat Religious Broadcasters Differently

In similar cases, two state taxing authorities have handed down divergent decisions involving religious broadcasters and their property tax exemptions. A Michigan case ruled that personal and real property owned by a nonprofit Christian broadcasting station was exempt from personal and real property taxes. The station uses the property to broadcast and disseminate faith-based programs, which the station argued was used solely for teaching religious truths and should be exempt from taxation. The state court agreed, finding that the station qualified as a house of worship, and all its property used in its religious mission was exempt. *Dominion Broadcasting, Inc. v. Fairfield Township*, No. 268756 (MI Tax Trib. 3/13/01).

But in a Pennsylvania case, the court wasn't so cordial. Local tax assessors levied property taxes on a Catholic broadcasting company and a trial court upheld the assessment, holding that the company did not qualify as a purely public charity. However, a state appeals court remanded the case for further review after finding that the company had to establish five factors in order to qualify as a public charity. It must prove that it:

(1) advances a charitable mission;
(2) operates free of private benefit;
(3) donates at least a portion of its services free;
(4) benefits a class of people who are legitimate subjects of charity; and
(5) relives the government of a burden.

It is this last factor that Pennsylvania and other states have focused more narrowly on in evaluating whether to provide favorable tax treatment. *Holy Spirit Radio Fnd. v. Bucks Cty. Bd. Of Assessment*, No. 1200 C.D. 2000 (5/4/01).

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