



Nonprofit *Alert*®

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

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How Much Is Enough?

Legislation Would Produce More Foundation Grants for Charities

Charities stand to benefit by millions of dollars if Congress adopts proposed legislation that places new requirements on private foundations. As the most ambitious legislation to affect foundations in years, the Charitable Giving Act (H.R. 7) represents a bipartisan effort aimed, in part, at curbing excess administrative expenses incurred by foundations. This legislation would require many private foundations to grant larger shares of their assets, creating upwards of almost a billion extra dollars in foundation grants annually, according to some estimates.

Administrative Costs

Federal law requires private foundations to spend at least 5% of their net assets each year for qualified charitable purposes (i.e. charitable grants), including any "reasonable and necessary administrative expenses." H.R. 7 would prohibit private foundations from counting administrative expenses, such as rent, salaries, and travel costs, toward the annual 5% distribution threshold.

Administrative costs at private foundations in the United States average 8% as a percentage of their payout distributions, according to a 1999 U.S. Treasury study.

If the law changes, prohibiting private foundations from applying administrative expenses toward the 5% threshold, then charities could conceivably receive more in grant funding because many foundations would be forced to distribute more of their assets to charity to meet the threshold. If private foundations don't meet the threshold, they risk incurring an excise tax and/or losing their tax exempt status.

Pros & Cons

Charities, of course, welcome this proposal, but private foundation officials voice concern for several reasons. Foundations experienced widespread declines in their investment income over the past several years, due to the market downturn.

Some believe this proposal would severely hurt overall foundation operations and eventually produce a long term negative impact on grant-making.

A second concern focuses on the increased level of disclosure and regulatory compliance that private foundations have faced in recent years. Such increased scrutiny has required additional compliance measures, which led to

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Liability & Risk Management

“Operation Phoney Philanthropy” Targets Scams

The Federal Trade Commission (FTC) and charity regulators in 34 states have teamed up this summer to launch “Operation Phoney Philanthropy”—a campaign designed to crack down on charity fundraising fraud. The joint effort comes after the FTC filed a rash of complaints earlier this year against five different fundraising companies, all for alleged charity fraud.

The cases are still pending, but each allegedly involved some type of fraudulent donor deception. At least two of the cases were filed against professional fundraising companies that conducted solicitation on behalf of various charities nationwide, including numerous police, firefighters, and veterans groups.

The FTC advises donors and charitable groups to be wary of solicitations couched in especially emotional or patriotic terms, or appeals geared to generate support based on current events, such as the September 11 tragedy. The FTC also strongly urges donors to ask telemarketers how much of the money they raise actually goes to support the charitable cause being marketed.

➔ **Charities can help this effort by educating donors about wise giving practices. For instance, charities could provide donors with the FTC’s “Charity Checklist,” available at <http://www.ftc.gov/charityfraud>. Donors will appreciate the information and develop greater trust in charities that provide wise giving tips.**

Court Rejects Hiring Policy for Females Only

A nonprofit womens’ shelter cannot turn down an applicant for employment merely because the candidate is male, the 7th Circuit U.S. Court of Appeals has ruled. The applicant applied for a position as a legal advocate. The position required the advocate to assist female clients in legal matters and other social services, but a shelter representative told the applicant he could not be hired because he was male, and the shelter “preferred a female legal advocate.”

The man then filed an EEOC discrimination claim, but a lower federal court dismissed the case, ruling the womens’ shelter was not an “employer” as defined in Title VII federal discrimination law.

On appeal, the 7th Circuit noted that Title VII covers employers “engaged in industry affecting commerce.” Because the womens’ shelter worked with out-of-state agencies, provided client services including transportation, shelter, medical, legal, and counseling services, and received funding from donors in several states, the court said the shelter’s operations clearly “affected commerce.”

The court ruled the shelter engaged in activities that “affected, interrupted, or promoted interstate commerce,” making it an “employer” under Title VII, and overturning the lower court’s decision. *Johnson v. Apna Ghar, Inc.*, No. 01_2015 (7th Cir., 6/4/03).

➔ **The “affecting commerce” hurdle is quite low, allowing courts to liberally enforce Title VII. Charities must adhere to Title VII just as commercial enterprises are required to do. Read Nonprofit Alert® Memo, *Employment Discrimination: Steering Clear in the Nonprofit Organization*, for details about how your charity can uphold its non-discrimination responsibilities and minimize potential employment liabilities. See back page to order Memos.**

Title VII applies to employers “engaged in commerce,” who employ 15 or more employees.

USPS Proposal: Charities May Split Mailing Costs

Just as the FTC lays down the battle lines against charity fraud involving commercial fundraisers, it seems the U.S. Postal Service (USPS) is taking a different approach. The USPS has proposed changing the rules that now prohibit commercial fundraising companies from sharing nonprofit mailing costs with the charities they represent.

Instead, USPS wants to permit charities and their professional fundraisers to share the costs of such joint mailings. Currently, federal law entitles charities to send mail at a discounted nonprofit rate if the charities meet certain requirements. One of those requirements is that charities must pay for 100% of the mailing costs of their direct-mail solicitations if they want those pieces mailed at the discount nonprofit rate.

The USPS’s proposal would allow a professional fundraiser to cover all or a portion of a charity’s mailing costs for a “cooperative mailing,” so long as the charity reaps a portion of the returns. And those solicitations could still be mailed at the discounted nonprofit rate.

Critics warn that this rule change would create an explosion of non-profit mail fueled by commercial interests, leading to abuses that would jeopardize the preferred-rate privilege. The USPS acknowledges this possibility, but argues that the proposal would benefit small nonprofits that can’t afford solicitation mailings. It is now considering public comments on the proposal; a final decision is expected sometime this fall.

Tax Exempt Issues

Teachers Aren't Ministers, Despite Board's Resolution, IRS Says

Teachers and administrators at a religious school are not ministers and do not qualify for the housing allowance tax exclusion, the IRS has ruled. The state-accredited school was operated by a church and employed all state-certified faculty. Teachers and staff were required to attend a church as part of their employment contracts, but they were not required to join the church that operated the school, nor were they required to hold a divinity degree or attend a Bible college of any kind.

The faculty received housing allowances after the school board approved a resolution implementing the policy for teachers and staff because they were "commissioned" as ministers of the gospel in their ministry to students. Upon investigation, the IRS found the "commissioning ceremony" consisted of a job interview, hiring plan, and contract negotiations.

The IRS determined that none of the faculty performed duties other than those ordinarily performed by secular school teachers and administrators, and that none of those duties included those traditionally performed by ministers of the gospel. The IRS concluded that the school faculty and administrators were not ministers of the gospel as defined in the tax code, and were therefore ineligible for the housing allowance exclusion. IRS TAM 200318002.

➔ **To qualify for these benefits, the individual must be a properly ordained, licensed, or commissioned minister who either performs sufficient ministerial services for the organization or is properly assigned to the organization by a church. For more information, see Nonprofit Alert® Memo, *Ministerial Housing Allowances: Qualifying & Documenting*. To order, refer to instructions on the back page.**

Merely naming an employee a "minister of the gospel" does not qualify him or her for a housing allowance exclusion or other ministerial tax benefits.

Publishing Contributor's Booklet Won't Affect Foundation's Exemption

The IRS has given the go-ahead to a private foundation that plans to publish and distribute a booklet that was previously published by one of the foundation's major contributors. The foundation supports health awareness programs by making grants to public charities.

The foundation's major contributor, a for-profit health care corporation, transferred to the foundation—for no charge—its entire interest in a health care booklet that the contributor had previously published and distributed. Hoping to expand its charitable activities, the private foundation then sought IRS approval of its plan to assume publication of the health care booklet.

The booklet would not carry endorsements of products or services and would be distributed free of charge. The booklet would account for about 1% of the foundation's annual expenses. Because there was no evidence to suggest that the publication of the booklet would create any prohibited private benefit to the health care corporation, the IRS saw no conflict, and concluded that all the self-dealing factors, which otherwise could have created a host of tax problems, were eliminated. IRS LTR 200309027.

Effect of Campaign Law Still Uncertain

A U.S. district court has struck down portions of the Bipartisan Campaign Reform Act, but the court stayed execution of its ruling until the case is appealed. Passed just last year, the Act prohibits corporations, nonprofits, and labor unions from funding "electioneering communications," defined as broadcast, cable or satellite communications that mention a candidate's name, reach a candidate's potential voters, and are made within 60 days of a general election or 30 days of a primary election.

The district court ruled that definition unconstitutional, but it accepted an alternate definition provided in the Act. If the alternate survives on appeal, nonprofits would be prohibited from making electioneering communications throughout the year, not just during periods prior to an election. *McConnell, et al. v. Federal Election Commission, et al.*, Civ. No. 02-582 (U.S. Dist. Ct., D.C., 5/1/03).

➔ **Because the court's ruling was stayed just days after it was handed down, it's not clear how the current prohibition on nonprofits would apply. Watch Nonprofit Alert® for updates, and of course, consult legal counsel before your charity engages in any candidate or issue advocacy.**

Nonprofit Alert®

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Foundation Giving *(continued from page 1)*

more administrative work and increased costs. Some argue that excluding those costs from the 5% threshold creates a disproportionate burden for private foundations.

Still another concern is that the proposed legislation might cause private foundations to cut back on administrative expenses, resulting in less support for and oversight of grant recipients. Some argue a better approach is to increase IRS oversight of foundations, instead of making it harder for foundations to oversee grant recipients.

However, supporters of the legislation say that private foundations should be devoting more of their resources to charity and less to administrative costs like rents and salaries. A study released by the charity watchdog group, the National Committee for Responsive Philanthropy, contends that private foundations would have to grant almost \$900 million more each year to charitable beneficiaries if the proposed legislation goes into effect.

Other Provisions

The proposed bill would also reduce the excise tax on private foundation investment income from 2% to 1%, which is good news for foundations. This means that private foundations would be able to preserve more of their investment income for grants and other uses.

Other provisions in H.R. 7 are similar to provisions in the CARE Act, which the Senate passed earlier this year. These provisions include the "non-itemizer" charitable tax deduction and the early IRA withdrawals for charity (see June '03, Nonprofit Alert®). If H.R.7 passes the House, those provisions are likely to remain intact, since they are virtually identical to the equivalent provisions in the CARE Act.

Learn More...

The study by the National Committee for Responsive Philanthropy is available at <http://www.ncrp.org>. Read the full text of H.R. 7 on Gammon & Grange's web site, <http://www.gg-law.com>.

Urgent Update: License Fee Options Change for Webcasters; Deadline Near

If your organization streams music on the web, you can now do it more cost-efficiently. In response to the outcry over the statutory license fees set last year by the Copyright Office, SoundExchange and representatives of noncommercial webcasters recently reached an agreement that allows noncommercial webcasters to elect alternative (generally lower) license fees. To take advantage of the alternative fees (instead of the U.S. Copyright Office's typically higher per-performance rates), noncommercial webcasters must notify SoundExchange (<http://www.soundexchange.com>) by **July 11, 2003**. For more information on these fees or other webcasting license issues, please contact Ken Liu at 703-761-5000 x131.

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