



Nonprofit *Alert*®

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

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➤ Workplace Issues

War Zone: Nonprofit Workers In Harm's Way

The war in Kosovo may be distant news, but some nonprofits are feeling the effects in their workforce. One of the most common issues is what to do when employees are called up for reserve military duty.

A 1994 federal law requires employers to hire workers back after they serve reserve duty, even up to five years from their departure. They must be rehired at the pay level and into the same or comparable position they would have attained if they'd never left. This applies equally to full-time and part-time workers.

Under the law, employers are not required to pay an employee on military leave of absence, although some companies offer differential pay, liberal leave, or a specific number of paid military leave days. Employers may face temporary burdens when key employees leave or return, but Defense Department officials say the law is necessary because it protects the men and women who serve the country.

➤ **For more information about an employer's responsibility, contact the National Committee for Employer Support of the Guard and Reserve, (800) 336-4590, or visit their web site at [http://](http://www.ncegs.org)**

Another, potentially more costly issue for nonprofits is how to insure workers who assist in the war effort as part of the organization's charitable mission. This is particularly difficult because relief workers are typically exposed to significant hazards beyond their organization's general insurance policy coverage. Either an organization can't find an insurance company to cover these risks, or what little coverage they find is not affordable. Some experts advise

nonprofits to disclose risks up-front when purchasing insurance, rather than struggle to add coverage later during a crisis.



Relief workers in war zones usually face significant risks, but so do employees or volunteers who serve in other volatile situations such as foreign locations or inner-city areas of unrest. If there's a possibility of a worker serving in high risk situations, that fact should be discussed with your carrier so acceptable coverage and costs can be negotiated. Ask about kidnap and ransom insurance along with high risk policies.

Supreme Court Rules, FTC May Regulate Nonprofit Trade Associations

The Supreme Court says the Federal Trade Commission (FTC) is within its powers to regulate nonprofit associations, especially those "whose activities provide substantial economic benefits to their for-profit members." The ruling involved a professional association that set advertising restrictions for its members. The FTC claimed the association's restrictions were anti-competitive, which hurt consumers. The association countered that the FTC didn't have authority to regulate nonprofits. The Court said the FTC had authority, but remanded the case for further consideration on the anti-competitive issues. *California Dental Assn. v. FTC*, U.S. Sup. Ct. No. 97-1625 (5/24/99).

~~~~~ **Looking for Something? Charity Search Tool Debuts** ~~~~~A new Internet search tool now synthesizes the mass of information available and highlights only those web sites that include nonprofit or philanthropic keywords. The search engine also allows users to browse categories of related sites. Find it at <http://www.philanthropysearch.com>.

## Liability & Risk Management

### Cell Phone Tragedy Offers Stark Liability Lesson

The brokerage firm of Smith Barney has settled a hit and run case which offers a liability lesson for all employers. An employee of the firm struck and killed a motorcycle driver when the employee accidentally ran a red light while reaching for his cell phone. The employee claimed he was making a business call to a client when he dropped the phone. As he leaned over to retrieve it, he ran the red light. The family of the motorcycle driver sued Smith Barney, accusing the firm of negligence for encouraging employees to conduct business while driving. Smith Barney countered that the firm encouraged employees to work solely from their offices and argued that the employee was outside the scope of his employment since the accident occurred at 9:30 p.m. on a Saturday night. Nevertheless, the firm reportedly agreed to the \$500,000 settlement because of concern that a jury trial would not end favorably, given the tragedy of the situation. *Roberts v. Smith Barney*, E.D. Pa.No. 97-CV-2727 (2/12/99).

➡ **Although the case didn't go to trial, lawyers on both sides said the message from the case was clear: employers could face liability when their workers do business from their cars. Employers should establish clear policies about what work, if any, is expected outside the office and use of cell phones while driving.**

### Partner Perils: Minister Liable for Employment Tax

A minister owned 40% stake in a land development company, which he co-founded and served as vice president. The minister planned a foster home for boys, to be funded in part by a sawmill being built on land the company purchased in Oklahoma. The company president managed the operation and handled all payroll accounts from the headquarters office in California, while the minister worked as on-site supervisor in Oklahoma. In 1992, the minister first questioned whether employment taxes were being paid. When he was unable to resolve the issue, he contacted the IRS. A year later, the company president disappeared, and the minister took over his duties. In 1994, the IRS assessed delinquent taxes against the company and held the minister personally liable as a "responsible person." The minister claimed he did not possess

the willful intent necessary for liability under the tax code's "responsible person" standard. He claimed the California partner duped him while he merely supervised field operations. However, the court did not relieve the minister of liability, despite these unfortunate facts, because he had hiring/firing authority, signed the company's federal payroll tax returns, and had signature authority on the company's bank accounts. His failure to pay taxes was willful, the court determined, because he admitted he "definitely knew" about the liability within a month after his initial inquiry in 1992, yet he still continued to pay employee salaries, including his own. *Holder v. USA*, Civ. 3:97-CV2993R (U.S. Dist.Ct., No.Dist.Tex., 3/18/99).

➡ **Liability under the "responsible person" standard is determined by an individual's status in an organization and the duty or authority of that position, not the individual's actual knowledge or understanding of that duty. That's why executives in both profit and nonprofit organizations must proactively exercise their legal duties—especially in paying taxes. When in doubt, seek immediate legal counsel (don't call the IRS first!).**

### Silicon Valley Group Rallies After Nonprofit's Fall

A Silicon Valley community group has come to the rescue of the United Way of Santa Clara County after it announced an \$11 million shortfall for the coming year. The budget problems trace to United Way's former CEO, who was fired in early May for exaggerating fundraising projections. United Way's board also claims the CEO didn't disclose important financial decisions to the board, which led the organization into financial straits without the board's knowledge. Most nonprofits facing such dire circumstances would likely go under, but in this case, the Community Foundation of Silicon Valley set up an emergency fund that has collected over \$6 million in pledges from high-tech firms including Infoseek, Ebay, and Hewlett Packard.

➡ **Since most organizations can't count on this kind of community bailout in times of financial crisis, a preventive approach is more preferable. Review Nonprofit Alert® Memos 9209-1, *Legal Duties of Nonprofit Directors* and 9106-2, *Accounting & Fiduciary Guidelines for Nonprofits*, which can help educate your board on establishing appropriate accountability measures for your CEO. See back page to order both memos.**

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## Employees & Volunteers

### Charitable Immunity Doesn't Protect Observer

A college professor, who voluntarily established a recreation program at a nonprofit youth club and "helped out" on a regular basis, is personally liable for injuries a boy sustained when his finger got caught in a door the professor closed. The boy's finger eventually had to be amputated. The professor was observing one of his college students who was conducting a wellness class during the recreation program at the club. At the request of the student


the professor was acting as doorkeeper so the student could instruct the class without interruptions. Because he was not “engaged in the work of the charity” at the time of the accident, the court said the club’s charitable immunity did not cover the professor. Instead, the court decided the professor’s role at the club was merely to observe the activities of his student. An individual seeking protection under the charitable immunity doctrine must establish that he/she is acting as an agent or servant of the charity to which the immunity applies in the first place, the court said. Here, the court ruled the professor was not performing any charitable work, but rather carrying out his role as a professor. *Mooring v. Virginia Wesleyan College*, No. 981270 (Va.Cir.Ct. Norfolk, 4/16/99).

 **The charitable immunity doctrine generally protects charities against lawsuits filed by their clients, but because of increasing litigation, the doctrine has been severely limited or even abolished in most states. To minimize risks, make sure all volunteers’ roles are clearly defined. Provide proper training and supervision, especially for those who play a “dual” role like the professor in this case. See NP9301-1, *A Prudent Volunteer Program for Nonprofits* for help.**

#### ***Uniquely Skilled Exec Merits On-Site Compensation***

His engineering skills gave the IRS good cause to approve a private foundation president’s compensation as reasonable, in light of his additional on-site duties in building a retreat and conference center. The president, who had a civil engineering degree and a unique understanding of the foundation’s mission, supervised the property development.

The foundation paid him and his wife (who also served as the foundation secretary) special compensation to live on-site and work as development managers during construction. The IRS said that although the two were disqualified persons under the private foundation regulations, their particular skills made the compensation reasonable and necessary to carry out the foundation’s purpose in constructing the facility. IRS LTR 199913040.

 **Learn how to handle special pay situations in your organization with NP9102-7, *Establishing Reasonable Compensation*, and NP9608-1, *Avoiding the Snares of Intermediate Sanctions*. See back page to order.**

## Tax-Exempt Issues

### ***Ordained Deacons Qualify for Housing Allowance***

The national conference of a worldwide church established an “order of ordained deacons,” whose members had the same or similar leadership, spiritual, and teaching functions as the clergy. Prior to adopting this new category, members of the clergy in that denomination were categorized as “ordained elders.” The difference between the two was that elders were appointed by a denomination were categorized as “ordained elders.” The difference between the two was that elders were appointed by a bishop, whereas deacons were not guaranteed a position or salary. Soon thereafter, a local church selected three individuals as ordained deacons.

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

### **Law Firm Runs Afoul of Copyright Rules**

The New York law firm of LeBoeuf, Lamb, Greene & MacRae has settled out of court with the Boston Copyright Clearance Center for an undisclosed amount, reports *The National Law Journal*. The firm allegedly copied materials to be used in-house without paying royalties to the publishers. The Clearance Center threatened a lawsuit on behalf of four publishers: Academic Press, New York Academy of Sciences, Public Utilities Reports, Inc., and John Wiley & Sons, Inc. The Center operates as a clearinghouse for almost two million publishers, handling blanket copyright licenses that businesses purchase annually to cover royalties on copies they make and use internally. The system is more economical and efficient than paying individual publishers every time a copy is made. The settlement includes a clause requiring the law firm to purchase a multi-year blanket license from the Clearance Center. Now, if a *law firm* encounters these copyright problems, certainly nonprofits risk stumbling in this area as well. “In some sense, nonprofits are more at risk than commercial enterprises because they don’t have the resources to properly review potential copyright issues,” says Timothy S. Kelley, formerly with Lawyers for the Creative Arts. To make matters worse, Kelley says exempt organizations may not even be aware of their violations. Copying material off the Internet presents special challenges, along with properly educating nonprofit staff members about the legal limitations of U.S. copyright laws. Kelley says the best protection a nonprofit can have against running afoul of the law is to always ask permission before using material that may be copyrighted.

**To protect proprietary material, tax-exempts should also register their own copyrights. For help both in registering your copyrights and respecting the copyrights of others, read Nonprofit Alert® Memo NP9208-2, *Copyright Law: Your Rights and Responsibilities* See back page to order.**

They held positions as Minister of Music, Minister of Education, and Minister of Stewardship. All three helped plan worship services, assisted with sacraments, officiated at weddings and funerals, and preached at worship services. The church asked the IRS whether they qualified to receive a ministerial housing allowance. After reviewing the applicable law, the IRS ruled the three individuals were, in fact, “ministers of the gospel” entitled to full tax benefits. IRS LTR 199910055.

➔ **The IRS was careful to point out, however, that the mere designation of someone as a minister or deacon was insufficient to qualify as a “minister of the gospel.” NP9101-5, Ministerial Housing Allowances, outlines all the requirements for this special tax break.**

### “Artful” Calculation Plagues Donations, Panel Says

In hundreds of cases last year, the charitable contributions claimed for donations of expensive art were at least 72% overvalued, according to a recent report from the IRS’s Art Advisory Panel, a group of experts that convenes regularly to review IRS positions on charitable gifts of art and other “priceless” items. The panel reviewed 973 items donated or passed to heirs in 1998 with an aggregate taxpayer valuation of over \$200 million dollars. Donors claimed an average deduction per item of \$81,975. The IRS will use the valuations in pending audits.

➔ **Although most nonprofits don’t often receive many pricey items like art, basic principles of valuation must be applied to all kinds of non-cash gifts, from real estate to autos. For a detailed explanation, refer to NP9109-6, Gifts of Property. See back page to order.**

## State Rules & Regs

### Georgia Exempts Sales of Artifacts to Nonprofits

Gov. Roy Barnes (D) has signed into law a measure that exempts the sale of artifacts from state sales taxes. The exemption applies to art and archeological objects as long as the sale is to a museum or similar tax-exempt organization that intends to display the objects as part of its charitable mission. GA H.B. 55.

### Pennsylvania Ends Exemption for Religious Pubs

The state’s Supreme Court has ruled as unconstitutional the state’s sales tax exemption for religious publications sold by

religious groups because it amounts to a governmental “preference for communication of religious messages,” which violates the Establishment Clause. The ruling relied on a 1989 U.S. Supreme Court decision that said tax exemptions for religious organizations must be sufficiently broad to encompass secular organizations. Here, the court found that the exemption had no such secular benefits. *Haller, et. al. v. Commonwealth of Pennsylvania*, No. 0049 M.D. App. Dkt. 1997 (Pa. 4/12/99).

➔ **Pennsylvania follows a number of states that have struck down similar tax exemptions for religious publications in recent years. The court suggested, however, that the statute would probably survive a constitutional challenge if it were revised to include non-religious organizations.**

### Minnesota Weighs Charitable Deduction Legislation

The House Tax Committee is considering three charitable tax deduction or credit bills that would give taxpayers who don’t itemize on their federal returns a break on their state taxes. An estimated 60% of Minnesota tax filers would benefit. The bills are similar to federal legislation currently being considered in Congress (NPA, May ‘99).

### Virginia Requires Exempts to Re-Apply Next Year

The state legislature has passed a measure requiring all ~~organizations~~ exempt from sales and use taxes under the educational, medical-related, civic and community service, cultural and miscellaneous categories to submit new information to the Department of Taxation as if they were re-applying for their original exemptions. The requirement is part of an overall review process the Department is putting in place to occur every five years on a staggered basis. Exempts have until July 1, 2000 to re-submit the required information.

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