



# Nonprofit Alert®

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

## 1. Nonprofit Overview

### 1.1 IRS Extends Deadlines in Two Major Employer Programs.

Two of the newest tax requirements employers now face are electronic employment tax filing and the worker classification program. Nonprofit employers have scrambled to implement both requirements, but the IRS recently granted deadline extensions, giving employers a brief respite.

◆ The deadline to enter the Electronic Federal Tax Payment System (EFTPS), extended an extra six months until January 1, 1999. The IRS estimates the extension benefits about one million taxpayers. Already, more than 1.5 million employers participate in EFTPS, but most are large businesses. The IRS extended the deadline because of small employer's administrative concerns.

◆ The Worker Classification Settlement Program (CSP) is available to all employers who may have misclassified employees as independent contractors and thus withheld too little or failed to report taxes. The deadline is extended indefinitely from its two-year trial period, which began in March 1996. The program allows employers to settle worker classification issues and resolve any associated tax burdens by paying only a minimum of what might ordinarily be assessed for improperly classifying a worker as an independent contractor. The IRS says the program is attracting unprecedented participation and extending it indefinitely will allow more employers to gain long-term benefits from the program.



**Evaluate the 20 criteria the IRS uses when making worker classification decisions with NP9110-2, *Will the Real Independent Contractor Please Stand Up?* See back page to order.**

**1.2 Membership Mail Meets 50% Limit Under New USPS Rules.** For more than two years, nonprofits and the Postal Service have squared off over the kinds of membership appeals and mailings that qualify for nonprofit postal rates. (See *NPA*, Apr. '97). Now, the Postal Service has proposed formal guidelines clarifying exactly what materials can be included in nonprofit mailings. Under the new guidelines, mailings that describe "member benefits" such as affinity credit cards, discounts on unrelated products or services, and other items offered as membership incentives that have no relation to a nonprofit's mission will lose nonprofit rates. Many charities have

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encountered stiff opposition from local postal officials who fined them for postage owed on mailings that used promotional language like "low-cost" or "discount" to describe member benefits. Such language, officials claimed, constituted advertising that is not entitled to the nonprofit postal rates.

★ **The guidelines will permit charities to use language like "low-cost" but only in mailings designed primarily as membership appeals. It cannot constitute more than 50% of the mailing's content. If the mailing contains more than one enclosure, the 50% rule applies to the whole mailing. No flyers or brochures are allowed as enclosures; only single pages describing member benefits are permitted.**



**The final version of the rule is due later this year. Watch *NPA* for updates, and prepare to meet the 50% rule when it becomes effective.**

## 2. Liability & Risk Management

### 2.1 Nonprofit Assessed \$1-Million for Volunteer's Conduct.

The 9th Circuit has upheld a \$1.09 million damage award against the Cult Awareness Network. The Court ruled there was sufficient evidence to support a jury's finding that a volunteer acted on behalf of the network when it referred the plaintiff to a "deprogrammer" who abducted and held the plaintiff's oldest son captive during five days of a deprogramming process. Two of the three-judge panel found that there was sufficient evidence that the volunteer had acted on the ministry's instruction and that the ministry knew or approved of her actions. *Tonkin v. Cult Awareness Network*, (9th Cir. 4/17/98).



**Volunteer liability can be quite costly for nonprofits as this case shows. Review the simple**

prevention steps in NP9301-1, *A Prudent Volunteer Program for Nonprofits*. See back page to order.

**2.2 Missed Deadline Forces Return of \$3-Million Gift.** A federal judge in New York has ordered the Beth Rivkah School, a private girls' school in Brooklyn, to return a gift worth nearly \$3 million to the original donors. A wealthy real estate developer and his lawyer donated the funds in 1992 for construction of a school building, on condition that the building be named after certain relatives and that it would be in use by December 31, 1995. When the deadline passed, the donors sued to get their money back, but the court granted the school's request for an extension to May 15, 1997 because poor weather had delayed construction. That deadline came and went with the building still not completed, so the donors renewed their claim. This time, the judge granted their request for a refund, saying that any other decision would allow the school to continue ignoring its contractual duties.

★ **The judge's comments give ample recognition to the hardship the school will face when forced to return the gift. But his greater concern was setting a bad precedent by not honoring a valid contract. See related Quote of the Month at ¶7.1, back page.**

**2.3 CBN Pays Big IRS Settlement, But Retains Exempt Status.**

The Christian Broadcasting Network (CBN), headed by evangelist Pat Robertson, has agreed to render a "significant payment" to the IRS and make a number of operational changes all because it allegedly engaged in partisan politics when it promoted Robertson's 1988 presidential campaign. The network also forfeits its exempt status for the years 1986 and 1987, but retains its current status as a 501(c)(3) organization. Three former CBN affiliates lost their exempt status, however: The Freedom Council, National Perspectives Institute, and National Freedom Institute. However, the three affiliates disbanded in 1986. The settlement also instructs CBN to refrain from all prohibited campaign activities and to increase the number of outsiders on its board of directors. The settlement comes after a 12-year IRS audit of the organization and its affiliates.

★ **The tax code prohibits exempt organizations from engaging in partisan politics. Penalties are severe, including complete revocation of exempt status. Although CBN escaped complete revocation, forfeiture of its exemption for 1986 and 1987 likely resulted in significant taxes owed for that period. The settlement does, however, maintain the deductibility of all donations received during those years, so that CBN donors remain unaffected.**

 **Don't let your organization fall into the tax trap of partisan politics. Read NP9101-3, *Nonprofit Lobbying and Political Activity—Know Your Limits*. See**

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## 3. Employees & Volunteers

### 3.1 FMLA Clock Starts Ticking with Temp Time.

Employers are not required to furnish permissive leave to an employee under the Family and Medical Leave Act until that employee has been on the job for at least a year. But exactly when the clock starts ticking depends on the employee's status. A federal court in Ohio has now ruled that the clock can start when an employee begins temporary work for the employer. The ruling permitted a six-month employee at Defiance Metal Products company to successfully claim the company violated her FMLA rights when it terminated her for absenteeism, even though FMLA coverage doesn't start until a worker has been on the job for at least a year. She worked seven months as a temp for the same company before being hired into a permanent position. This qualified her for FMLA coverage when combined with the six months in her permanent position. *Miller v. Defiance Metal Products, Inc.*, 1997 WL 809684 (ND OH, 1997).

★ **The court said the company and the temp agency, through which the company hired her, were actually joint employers during the employee's seven-month period of temporary work. But for purposes of FMLA, this counted toward the one-year requirement for coverage.**

 **This is a significant factor for nonprofits to consider when relying on temps. Understand the full implications of FMLA with NP9407-1, *All In the Family—Living with the Family & Medical Leave Act*. See back page to order.**

### 3.2 FMLA Clock Skips Time for Vacations & Holidays.

Although the case above demonstrates when the FMLA clock starts, this next case shows that it doesn't always tick at a steady pace. A hospital employee discovered this rule when he attempted to claim relief under FMLA for excessive absences. The employee admitted he had only worked a total of 1,037 hours over the previous 12-month period, which was short of the 1,250 hour requirement mandated for coverage by the FMLA, but he argued that vacation time and holidays made up the difference. The court ruled the FMLA clock *skips* time for vacation days, personal and regular holidays, days of suspension, and sick days because these are not hours compensated for actual work rendered, although an employee may receive paid leave for such days. *Clark v. Allegheny University Hospital*, 1998 WL 94803 (ED PA 1998).

### 3.3 Stress & ADA: Relief for Employer; Remorse for Employee.

In a discrimination case that has employers sighing relief, the Third Circuit Court of Appeals says that interpersonal conflict between co-workers isn't enough to require reasonable accommodation under the Americans with Disabilities Act. The case was brought by an AT&T employee who suffered depression and anxiety-related disorders. The company accommodated his hospitalization and medical leaves over an eight year period, but did not immediately grant the employee's request for a job transfer when he claimed stress from a personality conflict with another co-worker. The employee then sued AT&T for failing to accommodate his "disability."

Upholding a lower court ruling in favor of AT&T, the Third Circuit said the employee's proposed accommodation (i.e. a job transfer away from his annoying co-worker) was "wholly impractical" because it depended entirely on his varying levels of stress. The court said this precedent would force employers to transfer employees to different jobs or work environments anytime they felt "stressed out." *Gaul v. Lucent Technologies, Inc.*, 1998 WL 19937 (3rd Cir. 1998).

★ **With so many ADA cases imposing burdensome "reasonable accommodation" requirements on employers, this case brings a fresh reprieve of common sense. Congress did not intend for the ADA to interfere with an organization's personnel decisions, the Third Circuit said. It merely intended disabled employees to have the same opportunities as others.**



**Review what "reasonable accommodation" means for your organization. NP9109-3, *Basic Requirements Under the Americans with Disabilities Act* offers practical guidance.**

## 4. Tax-Exempt News & Issues

**4.1 Nonprofit Puts Director to Bed—With IRS Approval.** The tax code prohibits exempt organizations from providing goods and services to disqualified persons like executive directors because such acts amount to self-dealing, but here's one exception. The IRS recently permitted a private foundation to provide its executive director with an office that included a

kitchen, bathroom and a "murphy bed" built into the office decor because such amenities were "reasonable and necessary," given the director's unusual travel arrangements. The director lived out-of-state, visited the office regularly, and stayed in nearby hotels. His travel expenses, including hotels, were covered by the foundation, but the board objected to the costs. The board passed a resolution instructing the director to lodge overnight in his office and ended payments for his hotel expenses. The director was instructed to use his office and amenities only in his official capacity and to limit his activities in the facility exclusively to the foundation's business.

★ **Under these circumstances, the IRS said the amenities did not constitute self-dealing because they were necessary to the efficient performance of the director's tasks. IRS LTR 9805021.**

**4.2 Nonprofit Landlord Furthers Mission by Renting Building.** Operating a regional resource center in a building donated to a nonprofit 509(a)(3) supporting organization does not endanger the organization's exempt status, the IRS has ruled, because the resource center furthered the organization's exempt purposes of enhancing regional economic development and relieving the burdens of government. Managing the building was incidental to this purpose, the IRS said; therefore, rental income the organization received from certain nonprofit and charitable tenants in the building was not taxable as unrelated business income because it too related to the organization's exempt purposes. IRS LTR 9810038.

★ **Although the property in this case was not debt-financed,**

### *NPA Highlight of the Month*

## Bankrupt Donors: Can You Keep Their Contributions?

Suppose your organization accepted a generous contribution from a dependable donor last year, but now you've learned the donor just declared bankruptcy, and your organization may face a court order to return the contribution so the donor's creditors can be paid. Not fair, you cry? That's exactly what the Crystal Evangelical Free Church cried for the last six years, but only recently the church won a controversial judgement in a federal appeals court giving it the right to keep a \$13,450 tithing it received in 1992 from two church members who later went bankrupt. *Christians, Trustee v. Crystal Evangelical Free Church*, No. 93-2267 (8th Cir. 1998). The case has bounced in and out of courts on a number of issues (see *NPA*, June '96 and July '94), but this latest round invoked the Religious Freedom Restoration Act (RFRA). Last year, the Supreme Court sent the case back to the 8th Circuit for a rehearing after ruling RFRA unconstitutional. Now, the 8th Circuit says RFRA still applies to federal agents like bankruptcy trustees, despite the Supreme Court's invalidation of RFRA as a federal power over the states. The issue is far from finality in the courts, but clarity may come from Congress if it enacts a pending bill designed to protect charitable contributions from bankruptcy trustees and other creditors in a bankruptcy action.

★ **Introduced by Sens. Charles Grassley (R-IO) and Orrin Hatch (R-UT) in the Senate (S. 1244) and by Rep. Ron Packard (R-CA) in the House (H. 2604), the Religious Liberty and Charitable Donation Protection Act would allow donors to give up to 15% of their gross annual income to charity without the threat of creditors suing the charities to return the funds if donors later declare bankruptcy. More than 100 co-sponsors have already signed onto the mea-**



**Nonprofit leaders are watching both the *Crystal Evangelical Free Church* case and the pending legislation before Congress because an unfavorable outcome (especially in light of the New Era case; see *NPA*, Nov. '97) would seriously erode the historic inviolability of charitable contributions and significantly increase the costs of fundraising. If your organization is interested in supporting this legislation or similar measures, contact Pete Rathbun or Chip Grange at Gammon & Grange, (703) 761-5000.**

many nonprofits encounter additional limitations when they attempt to collect rent from debt-financed properties. Before leasing out your office space, review the UBIT rules with NP9110-1, *A UBIT Primer for Nonprofits*. See back page to order.

## 5. State Rules & Regulations

### 5.1 Massachusetts Exempts Nonprofits' Video & Film Sales.

The state appellate tax board has ruled that Massachusetts' sales tax exemption for publications sold by nonprofits includes educational films and videos, along with printed material. The tax board said the exemption is not based on the medium used, so long as the information conveyed is educational in nature. *National Fire Protection Assn. v. Commissioner of Revenue*, No. F224284 (Mass.App. Tax Board, 12/29/97).

### 5.2 Washington State Considers Fundraising Exemptions.

The state legislature is debating a bill to create new sales tax exemptions for fundraising sales by charities. However, sales do not include operating a regular business that conducts sales, such as a bookstore or thrift shop. WA H.B. 2428.

★ **Small business owners have opposed similar measures because they fear the exemptions will impact their sales, but this bill is picking up greater support than prior bills.**

## 6. Gifts & Fundraising

### 6.1 Charitable Benefit Warrant: The Latest Financial

**Product.** A new financial instrument designed to benefit charities has appeared on the market. Offered by Ixion Biotechnology, a Florida research firm, the Charitable Benefit Warrant makes up one-fourth of a share of the firm's common stock. The company recently announced an initial public offering of this special stock. Certain restrictions apply, however. For instance, during the first ten years after purchasing the stock/CBW combination, a shareholder cannot exercise any CBWs, but the shareholder can transfer the CBWs to one of several selected charities

participating in the project. The charity may then exercise the CBW during that period at a price of \$20 per share.

★ **Ixion Biotechnology specializes in diabetes research. Accordingly, it selected charities with a similar focus for the IPO, including the Juvenile Diabetes Foundation, and the National Kidney Foundation.**



**For more information, visit: <http://www.ixion-biotech.com>. A prospectus is also available at this Web site or by contacting the company directly.**

## 7. Executive Items of Interest

**7.1 Quote of the Month.** "...THE GREATER BENEFIT ... IS THE PUBLIC POLICY INTEREST IN MAINTAINING THE INTEGRITY OF CHARITABLE DONATIONS THAT ARE MADE CONTINGENT UPON TERMS THAT THE PARTIES HAVE AGREED TO."—Honorable Clarence C. Newcomer, U.S. District Court in Philadelphia, in ruling that the Beth Rivkah School must return a \$3 million donation for failing to comply with conditions imposed by the donors. See story at ¶2.2.

### 7.2 Nonprofit Salaries Lag, But Vacations Outpace Industry.

A new survey finds nonprofit salaries continue to lag behind those in the commercial and government sectors, but health benefits compare favorably and annual leave benefits are more generous. On average, nonprofits give 12 annual vacation days, while employees in for-profit industry get only 10 days.



**Details on the survey are available from the Applied Research and Development Institute in Denver, CO at (303) 691-6076.**

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