



Nonprofit *Alert*®

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

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City Ordinance Can't Regulate Charity "Integrity"

Warren v. Commissioner

Parsonage Exclusion Sparks Constitutional Q's

The closely watched ministerial housing case, *Warren v. Commissioner* (now on appeal before the 9th Circuit), took a surprising turn recently when the court asked for an additional brief on the constitutionality of the parsonage exclusion. The request represents what many believe is a clear invitation by the court to challenge the constitutionality of the parsonage exclusion itself.

Although neither of the litigants argued the constitutional issue, the 9th Circuit requested Professor Erwin Chemerinsky of the University of Southern California Law School, to file an amicus brief addressing whether the parsonage exclusion violates the separation of church and state. The parsonage exclusion law, which has been on the books since 1921, provides clergy a tax exemption for their housing costs.

The case is on appeal from the Tax Court (See *NPA*, July'00) where the primary issue was whether fair rental value caps the housing allowance exclusion. Rev. Warren claimed an exclusion, based on actual expenditures, but the IRS said the allowance is the lesser of actual costs or fair rental

value. Many fear the appeals court will strike down the parsonage allowance on the grounds that it unconstitutionally advances religion by providing a tax benefit only for religious persons but not for anyone else. It's unclear whether

the court even has authority to entertain this question on its own motion, when neither litigant previously raised the issue in lower court nor voiced any interest in raising it. If the *(continued on back page)*

Association Assessed UBIT on Ad Income

The 8th Circuit Court of Appeals has affirmed a Tax Court ruling that advertising revenues the Arkansas State Police Association received from publication of its annual magazine constitutes unrelated business income (UBI). The ruling makes the association liable for UBI tax on nearly \$900,000 in income.

The association treated the income as non-taxable royalties, but the IRS disagreed. The association argued the money shouldn't be taxed because the association had only passively participated in producing the magazine.

The association contracted with a publishing company to handle all publishing issues, including the sale of ads.

The 8th Circuit ruled that advertising income was not a royalty, regardless of whether the association's participation was only passive.

The Court emphasized that "royalties" typically arise if an organization is paid by another entity that receives a right to use the organization's name. In this case, however, the Court found that the association was merely promoting its own name in its own magazine. No royalties could be produced under those circumstances, the court said. *Arkansas State Police Assoc., Inc. v. Comm. of Internal Rev.*, No. 01-2255 (8th Cir, 3/6/02).

Average Taxpayer Takes About \$2,000 in Deductions

Average deductions for charitable contributions taken by taxpayers in 1999 (the latest year for which figures are available) have just been released by RIA, a tax information publisher, using statistics provided by the IRS. Taxpayers were broken into seven categories, depending on income, ranging from the lowest bracket (\$35-49,999 in income) to the top bracket (\$1 million and over). In the lowest bracket, the average charitable deduction was \$1,758. In the top bracket, the average was \$149,945. Combining figures for all the categories of taxpayers earning \$100,000 or less, the average deduction was \$2155.

Liability & Risk Management

Charity Says “No Thanks” to Court’s Volunteer

What seemed like a good idea met with a resounding “no thanks” when officials at the Pro Kids Golf Academy learned they’d be receiving help from a new volunteer: a former San Diego prosecutor, sentenced to serve 350 hours of community service for stealing government property and misusing his staff. The prosecutor was also a skilled golfer, so—without asking the charity—the judge ordered him to volunteer at the nonprofit Academy, teaching golf to inner city kids. The Academy objected because its teaching faculty consisted only of professional golfers, and the prosecutor didn’t qualify. Academy officials also voiced concern over putting a criminal offender in charge of children. The judge relented and set a new hearing to consider alternative service assignments.

Officials objected to the idea of a felon dealing with kids.

➔ **Charities can say no in these cases if unsuitable volunteers are thrust upon them for community service. Despite the unusual circumstances of this case, the point to remember is that charities must screen all volunteers and consider their suitability for service. This may lead some charities to turn away certain volunteers, but better to say no than to assume liability for volunteers who’ll increase your risk exposure or jeopardize your mission.**

First Amendment Free Exercise Clause Offers No Protection in Clergy Sex Abuse Cases, Court Says

The Supreme Court of Florida has denied relief to the Roman Catholic Church in a negligent hiring and supervision case brought by victims of alleged clergy abuse. The church argued that a secular court should not be allowed to adjudicate such claims because the First Amendment Free Exercise Clause prohibits governmental intrusion into the internal affairs of religious organizations. But the court disagreed, finding that certain conduct is subject to regulation for the “protection of society,” despite the separation of church and state doctrine.

➔ **The U.S. Supreme Court has never explicitly ruled whether the First Amendment protects religious organizations from liability in these sexual abuse cases, so this state court ruling may be a sign of developments yet to come on the federal level—especially now with so much attention focused on clergy abuse.**

B*I*N*G*O Bashing Executive Spells ‘Sue Me’
“Frank communications” about officers of fraternal organizations are conditionally privileged communications when they’re made only to members at a confidential meeting—even when the statements are included in the minutes of the organization, a court in Maine has ruled. This case involved a Ladies Auxiliary group bingo party. The group’s president-elect reportedly won the bingo game on two consecutive nights and received the prize: free bingo cards for the next game. But the president-elect unilaterally revised the receipts and took a credit for the bingo cards she’d already purchased. When other members of the Auxiliary found out, they called her act inappropriate; one member’s statement that this behavior was “intentional, dishonest and illegal” found its way into the minutes of the meeting, which were then read aloud at the next full membership meeting. Once the minutes were made public, the president-elect sued for defamation, claiming the reading of the minutes constituted publication of the defamatory comments. A lower court awarded her \$20,000, but on appeal the Maine Supreme Judicial Court reversed, saying that such organizations have an interest in maintaining integrity, which requires “frank communications”

Not every comment made is appropriate for inclusion in the minutes of meeting.

about an officer’s actions. As such, the statements were conditionally privileged when made at a confidential meeting as occurred here, the court concluded.

➔ **Bingo bashing may seem comical, but defamation is no laughing matter. Protect and preserve confidentiality in closed meetings when sensitive topics are discussed. Not every comment made at a meeting is appropriate for inclusion in the minutes. Besides lawsuits, damaged relationships and reputations can be avoided with a careful pre-publication review of the minutes.**

Employees & Volunteers

Employer Not Liable for Hiring Habitual Offender

The Virginia Supreme Court has relieved a university alumnae association of liability for injuries an employee caused while driving a university truck. The association isn’t responsible for negligent hiring, the court said, because it wasn’t foreseeable that the employee would take the truck without permission while he was intoxicated and crash it, causing injury to others. The association hired the employee as a temporary building assistant through a staffing agency. Both the university and the staffing agency failed to validate his driver’s license or conduct a background check into his driving record. If a check had been

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made, it would've shown two DUI's, failure to attend alcohol counseling, and designation by the state DMV as a habitual offender. Nevertheless, the court said it was not foreseeable that a temporary employee, hired only to perform clerical and light labor duties with incidental responsibilities to drive less than a mile to the post office every day, would commit such acts or pose a threat to others. *Interim Personnel of Central Virginia, Inc. v. Messer*, VLW 002-6-035.

 Perhaps the court was more lenient in this case because the university reasonably relied on the temp agency. Nevertheless, an employer should always assume that it is liable for employees and should, therefore, conduct background checks and confirm all required licenses or certifications before hiring.

Habitat for Calamity: Federal Law Covers Volunteer

Relying on the Volunteer Protection Act of 1997, a Connecticut court has held a volunteer immune from liability for injuries that occurred to a woman working in a ticket booth that the volunteer helped build. A nonprofit booster club for a school sports team owned the booth. The club was authorized by both the school and the Board of Education to construct the ticket booth. The volunteer was not compensated for any aspect of his work on the booth. The court said the volunteer was well within his responsibilities as a volunteer when he worked on the booth, and was, therefore, covered by the immunity protections of the act. *Guadet v. Braca*, CT Super.Ct., CV 98351943S (2001).

 The Volunteer Protection Act covers volunteers who work for charitable organizations, but it does not

provide protection for organizations themselves. (See NPA, June'97). It is no substitute for due diligence in hiring or screening volunteers. Read Nonprofit Alert® Memo, *Managing Volunteers: Risks & Rewards*, for more guidance. See ordering info on the back page.

Tax-Exempt Issues

“Urning” Donations: “Dual Character” Payments

The IRS approved a Catholic parish's fundraising campaign which offers members the right to use certain niches in the church's columbarium (burial vault) for displaying urns containing cremated remains, in exchange for specified payments. The payments are significantly more than the fair market value for such rights, so the excess will be a charitable donation to the church. The church's receipts to donors will clearly state which portion of the donations are payments for the use of the niches, and which are deductible charitable gifts. The IRS approved the plan because it fits within the parameters for “dual character payments” (i.e. payments solicited during fundraising and intended to be partly a donation and partly a payment for goods or services received by the donor). None of the income the parish receives from the program will be subject to unrelated business income tax: Congress intended for churches to operate columbaria or cemeteries without paying income tax as long as the operations

NPA Highlight of the Month

City Ordinance Can't Regulate Charity's “Integrity”

A Nashville city ordinance that regulated fundraising based on a charity's “character and integrity” violates the constitutional principles of free speech, a federal judge ruled last month. The judge issued a preliminary injunction prohibiting Nashville from enforcing the ordinance and allowing the Oklahoma-based charity, Feed the Children, to proceed with its fundraising campaign.

The ordinance gave the Metro Nashville Charitable Solicitation Board authority to consider a charity's “reputation for honesty and integrity” when granting or denying solicitation permits. The board relied on the ordinance to deny Feed the Children a permit in 2000, citing legal allegations against some of the charity's employees as reason for the denial. A year earlier, state investigators charged Feed the Children employees with stealing clothes and other donations. Later, the charity's chief financial officer pled guilty to forging the organization's financial statements. Some of those forged financial statements were used to secure previous solicitation permits in Nashville.

The judge said allowing a city to consider a charity's character paves the way for city officials to discriminate against a charity based on whether they agree with the charity's mission or viewpoints, a clear violation of constitutional free speech protections. Although the Nashville ordinance seemed “benign at first blush,” it ultimately gave city officials too much discretion when approving or rejecting charities, the judge concluded.

 Local regulation of charitable solicitation has proliferated widely in recent years. Despite frequent constitutional challenges to more aggressive legislation of this nature, local jurisdictions continue to aggressively regulate charitable solicitation. Arbitrary discretion and enforcement by regulations is also a problem. For example, Gammon & Grange once challenged a state's improper denial of charitable registration by demonstrating that the regulator violated the process required by state statute. The regulator defended his decision by uttering the immortal words, “We don't really follow the law down here.” The state eventually reversed course, but it's clear that both knowledge and diligence are needed when pursuing charitable solicitation compliance. Request a free copy of Nonprofit Alert's practice pointers page on charitable solicitation laws by emailing us at npa@gandglaw.com.

are carried on in connection with the church's activities, the IRS said. IRS LTR 200213021.

 **This case demonstrates what the IRS looks for when charities conduct fundraising programs connected with the sale of goods or services. "Dual character" payments are permissible as fundraisers, if the charity is clear about what portion of the payment constitutes a gift, and what portion constitutes a payment.**

Ministry Equals "Alter Ego;" Assets Split in Divorce

The Nebraska Supreme Court has ordered nearly \$1.3 million in assets belonging to the Omaha-based Union Oaks Ministry to be split equally between the pastor and his ex-wife in their divorce settlement. Ordinarily, nonprofit assets are not counted as marital assets, since they do not "belong" to employees of the ministry. But in this case, the court said the ministry operated as the "alter ego" or "business conduit" of the pastor, making it possible for the court to reach those assets. There was little evidence regarding donations the ministry received or its religious practices. The court questioned how active the ministry had been since its incorporation. Although the ministry was granted tax exempt status by the IRS and had been in existence since 1971, the court was concerned because the ministry apparently operated off gains on the purchase and sale of real estate that the pastor managed.

 **One would expect the IRS to be contacting the minister soon to determine whether payments he received were "excess benefit transactions" or private inurement, subjecting the recipient to penalties of up to 200% of any accounts received. For more information about what constitutes excess benefit transactions, see Nonprofit Alert® Memo, *Intermediate Sanctions Law*, available from Gammon & Grange. Ordering instructions appear at right.**

Parsonage Exclusion Questions.....(continued from p. 1)

court strikes down the parsonage allowance, this is an issue that would certainly be argued on appeal to the Supreme Court.

Meanwhile, the House of Representatives voted last month to revise the tax code so that it specifies the parsonage exclusion applies to the fair market rental value. H.R. 4156 now goes to the Senate for consideration. If passed, the bill will arguably moot this case in the 9th Circuit, since it would resolve the question the parties thought they were litigating.

Religious organizations must follow this issue closely in the coming months. The outcome of the case will likely determine whether actual costs, or fair market value is to be used in figuring the extent of parsonage allowances. More significantly, it may affect whether the allowance can be claimed at all. It may also have implications for whether rights traditionally and widely accepted as constitutionally appropriate will be preserved or undermined.

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