



Nonprofit *Alert*®

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

Inside This Nonprofit *Alert*®

LIABILITY/RISK MANAGEMENT.....p.2

- ★ Authorities Go After Unruly Trustees
- ★ Fundraising Misdeed Cost \$75,000

EMPLOYEE/VOLUNTEERS LIABILITY....p.2

- ★ Mileage Benefits Extend to Auto Leases
- ★ No Uemployment Exemption for Campus Ministries

TAX-EXEMPT ISSUES.....p.3

- ★ Split Interest Complicate Deductions
- ★ Turnig the Tables on UBIT

STATE RULES & REGS.....p.4

Plus NPA Highlight of the Month:
Accounting for Fundraising.....p.3

Nonprofit Overview

Congress Extends Copyrights to 70 Years, Plus Additional Protection for Some Nonprofits

Congress passed a compromise bill last month extending copyright protection for up to 70 years after the life of the author. (Prior protection lasted only 50 years beyond the author’s death.) The measure brings U.S. copyright law into conformity with international laws, which already extended protection for 70 years. It also maintains the current “fair use” provisions that permit limited use of copyrighted material so long as such use is strictly for non-commercial, educational, or research purposes. A companion bill, known as the Digital Millennium Copyright Act, adds protection for nonprofit libraries and educational institutions against copyright infringement lawsuits that result from student or employee use of on-line services provided by the institutions. At press time, the bills were awaiting the President’s signature, but he has already indicated support of both measures.

 **This is good news for all nonprofits that hold copyrights, and it’s especially good news for nonprofit institutions weary of potential liability from operation of on-line services. For a more detailed discussion of this new legislation, refer to NP9208-2, *Copyright Law: Your Rights and Responsibilities*. See back page to order.**

Charities Prepare for Coming Disclosures

The Treasury Department is expected to issue final regs soon explaining how charities must comply with disclosure rules that were put in motion when intermediate sanctions legislation passed in 1996. To help charities position themselves for compliance, a nonprofit education group is offering to post charities’ Form 990’s and 1023’s on-line, free of charge. The law permits Internet posting in lieu of providing copies of Form 990’s, 1023’s, and other documents to the public upon request. Many charities favor it because of cost and time savings.

 **The posting service is available through DU Educational Technology Services. For details, visit their web site at: www.interlog.com/~mercere/access.html.**

Controversial Litigation Finally Ends . . .

Supreme Court Won’t Revisit Case of Bankrupt Donation Pursued by Trustee

The Supreme Court has refused to hear the appeal of a case that attracted nationwide attention for the last seven years as a bankruptcy trustee attempted to force a Minnesota church to return \$13,450 in donations from a couple that declared bankruptcy in 1993. The Eighth Circuit Court of Appeals ruled for the church, but that decision was returned for further debate when the law on which it was based (i.e. the Religious Freedom Restoration Act) was overturned. Upon reconsideration, the Eight Circuit again ruled in favor of the church, leading to the Supreme Court appeal. The high court’s refusal to hear the case lets the Eighth Circuit ruling stand as precedent.

★ Some experts had predicted the Supreme Court might use this case to clarify its position on RFRA. But the Religious Liberty and Charitable Donation Protection Act, passed earlier this year (NPA, July ‘98), made the issue moot since it now prohibits bankruptcy trustees from claiming donations made to charitable organizations within certain parameters.

Liability & Risk Management

State Fights to Remove Trustees for Breach of Duty

Hawaii's attorney general is attempting to remove all the trustees of the Bishop Estate trust, the wealthiest charity in Hawaii, for "multiple profound breaches of trust," according to court documents. The trust is worth an estimated \$10-billion and has wide-ranging business investments from real estate to banking. An investigation begun last year (NPA, Nov. '97) has now revealed that the trustees and their relatives personally benefited through many improper deals, including kickback schemes and lucrative contract awards. In addition, the trustees reportedly received an average of \$840,000 each in annual salaries from the charity. Founded by Hawaii's last princess in 1883, the Bishop Estate trust operates with a single beneficiary, the Kamehameah Schools for students of native Hawaiian ancestry.

★ **The attorney general's investigation also found evidence of generous contributions to state politicians, plus more than \$900,000 spent to lobby against federal and state legislation that prohibits excessive fees to trustees and other charity "insiders." At the federal level, that lobbying effort failed with the passage of intermediate sanctions. Now, the trustees could face charges and penalties under that law.**

Charity Pays \$75,000 to Settle Fundraising Uproar

The Childhood Leukemia Foundation, based in New Jersey, must pay \$75,000 to two Oregon charities, plus an additional \$10,000 to the state for administrative costs in settlement of charges for misrepresenting itself during fundraising. The organization allegedly told donors their contributions would support a camp, a children's hospital, and a cancer group. But the camp doesn't exist, and neither the hospital nor the cancer group ever received any funds nor gave permission for their names to be used in fundraising. Each will receive half of the \$75,000 settlement.

➡ **Your organization's name may be its most valuable asset. Ask your staff, volunteers, and even donors to alert you of any incidents of infringement or other apparent misuse.**

Nonprofit Liable for Swimming Pool Accident

A community recreation center, that managed a swimming pool, is not relieved of liability for a wrongful death under the

charitable immunity doctrine because it was not actually operating as a charitable organization, the Virginia Supreme Court has ruled. Although the center was formed as a private, non-stock corporation in 1964, the court found its overriding purpose was "to own and operate a private facility exclusively for its members." Such purpose, the court said, did not meet the state's requirements for a charitable objective. The court was also swayed by the center's operation as a for-profit organization for several years prior to the case. Merely renting the facility to other nonprofit groups like the Boy Scouts and the Red Cross did not establish its charitable nature, the court said, nor did its lack of profitability in recent years. *Bailey v. Lancaster Ruritan Recreation Center, Inc.*, 13 VLW 485 (1998).

★ **The charitable immunity doctrine generally prevents lawsuits against charities by beneficiaries who are served by such charities. But because of increasing litigation, the doctrine has been severely limited in most states.**

Employees & Volunteers

Campus Ministry Not Exempt From Unemployment

Campus Crusade for Christ, a tax-exempt religious order, must pay state unemployment compensation benefits because it is not affiliated with a church, says a Florida appeals court. Despite its clear religious mission, the organization does not meet the state's strict standards for a religious exemption from unemployment liability, namely that the organization must be "operated, supervised, controlled or principally supported by a church or association of churches." The court cited "critical differences" between the state's definition and the organization's operation, including a lack of ordained ministers, no established liturgy or sacraments, and the fact that the organization encouraged its staff to join local churches. *Campus Crusade for Christ v. Unemployment Appeals Commission*, 702 So.2d 572 (Fla. Dist. Ct. App. 1997).

➡ **Although federal laws protect religious orders much the same as churches, state laws are not always so predictable. If you operate a ministry, don't assume it qualifies for automatic state exemptions because of its religious nature or because it is exempt at the federal level. NP9207-2, *The Overlooked Tax-Exempt Harbor of Religious Order Status*, outlines the basic federal rules. See back page to order.**

Have Car, Will Travel—And Deduct Auto Lease

IRS rules that, for years, permitted volunteers to deduct their charitable use of personally owned autos, have just been extended to cover auto leases. The IRS issued final rules last month expanding the limited category of deductions because of the increased popularity of auto leases by individuals and corporations. This deduction is not, however, available to borrowers or other non-owners. Reg §1.274(d)-1T.

★ **For nonprofits, this issue arises when organizations reimburse employees and volunteers for mileage. These final**

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regs make the current rate, 32.5 cents per mile for employees and 14 cents for volunteers, now available to auto owners and leases.

➔ A minor revision in your organization's employee expense policies may be in order to clarify this extended availability. Use NP9103-3, *Expense Reimbursement for Volunteers and Employees* to review your policies. See back page to order.

Tax-Exempt Issues

IRS Casts Weary Eye to Split-Interest Insurance

Recent remarks by IRS officials indicate the Service is targeting a hybrid insurance product being marketed to charities and donors. Varying the traditional employer/employee reverse split-interest insurance ("RSI") concept, charitable RSI is a whole-life insurance policy on a donor's life, purchased by a separate trust or corporation of which the donor or his/her heirs are controlling shareholders. The charity contributes a share of the insurance premiums and then splits all proceeds, including death benefits. Funds for the charity's share of premium payments come from unrestricted charitable contributions from the donor, who takes a tax deduction for these contributions. In many cases, the amount the charity pays in total premiums exceeds the benefits it receives. However, since the donor makes regular

contributions sufficient to cover the premiums, the charity incurs no net costs, and receives a benefit upon the donor's death. Questions have arisen about the true charitable nature of these CRSI's, including:

whether they are really only partial interests in the insurance, which means the donor cannot take a full deduction; whether the donor is really receiving quid pro quo for the gift (i.e. the share of the death benefit not payable to the charity); whether this whole arrangement is really just subterfuge for conveying private benefit without tax consequences.

★ The National Committee on Planned Giving says these are high-risk ventures that may expose donors to adverse consequences and endanger a charity's exempt status.

➔ Exercise extreme caution with these products. Either get competent counsel's opinion or postpone any such deals until the IRS issues more definitive guidance. Early indications from IRS officials have not been favorable toward these products.

Turning the Tables . . . And Chairs . . . on UBIT

A charity that conducts an annual agricultural fair escapes unrelated business income tax on the rental of its fairgrounds, but must pay the tax on proceeds it collects from renting its personal property, including tables and chairs, according to a new IRS ruling. The IRS wasn't concerned with the fairground rental, but focused instead on various service charges and facility fees the group imposed. Among those fees were charges for use of the group's public-announcement system, parking, security, trash collection, recreational hookups, equipment setup, and tables

NPA Highlight of the Month

From Visas to Value-Added Taxes,

International Issues Abound for Nonprofits

Suppose your organization just received an exciting invitation to partner with a European charity that has a similar mission and clientele. Or suppose your organization decides to open a branch office in South America so it can establish an outreach program for needy people in developing nations. Better yet, imagine your organization receives a sizeable donation from a wealthy Japanese investor who stipulates the money be used for training charity workers throughout Asia. Such scenarios may present irresistible service opportunities for your organization, but the practical aspects of operating on an international scale create a host of interesting legal issues—most of which do not arise in purely domestic settings. For example, many countries enforce complex formalities for establishing a nonprofit, leaving a U.S. organization with little or no control over its international counterpart. Foreign tax, accounting, and contracting laws must also be fully reviewed and observed. Other primary areas of legal concern for nonprofits expanding internationally include employment laws (especially visa requirements) and intellectual property rights.

★ Some nonprofits leap into the international arena without proper preparation. The realization can be sobering, as one U.S. nonprofit learned when it met resistance from its foreign operation. From the outset, relations had been built on trust and goodwill between the two organizations, but when the director and board members of the foreign operation decided to adopt radically different policies from the U.S. "home office," the U.S. organization could do very little to stop them. The foreign operation was separately incorporated, owned its own U.S.-registered copyrights, and maintained their own local membership. This left the U.S. organization at a serious loss to protect its own name and reputation.

➔ A new Nonprofit Alert Memo, NP9811-1 *Operating Nonprofits Internationally*, addresses the basic issues nonprofits should consider when expanding beyond their U.S. borders. Authored by James K. Lockett, who recently left his international law practice in Brussels to join Gammon & Grange's international business practice, the memo is a valuable tool for organizations involved in or considering international work of any kind. See back page to order.

and chairs. The IRS deemed the announcement system, hookups and set-ups were "services for the occupant" on which UBIT was owed. The other services were not clearly for the occupant's benefit, so no UBIT applied, except for the tables and chairs which fell under a different analysis that invoked the "10% rule."

★ **Tax rules exempt rental income on personal property (like tables and chairs) if it doesn't exceed 10% of the total rent from real property (i.e. fairground). In this case, rent on the tables and chairs far exceeded the 10%, so the IRS imposed additional UBIT on those proceeds. IRS TAM 9835001.**

➔ **Do you charge similar fees? If so, review your facility-use policies to determine the potential for exceeding the 10% limit. Consult an attorney or tax advisor if you need to revise or draft a new policy.**

Good News Just Got Better: Deductions Increase

Data recently released by the IRS indicates the amount of charitable deductions claimed by U.S. taxpayers in 1996 rose by about 15% over 1995 levels. Earlier, the IRS reported the increase was 12%, but further analysis completed during recent months, shows the IRS's original figures were short.

➔ **Copies of the 1996 stats, the latest available, are \$15 from the Superintendent of Documents, U.S. GPO, P.O. Box 371954, Pittsburgh, PA 15250-7954.**

State Rules & Regs

California Imposes Registration on Consultants

California has closed a loophole that previously excused fundraising consultants from registration. Now, consultants and solicitors alike must register, provide details about their work and clients, and pay an annual fee.

★ **The law exempts consultants whose total annual gross compensation is \$25,000 or less. Otherwise, consultants have until January 15, 1999 to register with the state.**

Kansas Department of Revenue has ruled against a church that tried to claim a sales tax exemption for telephone services it purchased for its priest because the line is listed as the priest's private phone and is not used exclusively for religious purposes. KS No. P-1998-96.

LLC Company Qualifies for New York Exemption

Brookhaven Science Associates, a limited liability company formed for scientific research and education, qualifies for a sales tax exemption, the New York Department of Taxation has ruled. The company was formed from a collaborative effort of its two owners, one a 501(c)(3) and another that had previously relinquished 501(c)(3) status. However, the company's operating charter limits its earnings and asset distributions to shareholders that are also exempt under state law. Because the company's mission was exclusively for tax-exempt purposes, the state permitted the exemption. *Dept. of Taxation & Finance, Taxpayer Svc. Div., Technical Svc. Bureau, TSB-A-98(14)S.*

Quote of the Month. "EFFECTIVE GOVERNANCE BY THE BOARD OF A NONPROFIT ORGANIZATION IS A RARE AND UNNATURAL ACT." — Barbara Taylor, Richard Chait and Thomas Holland, authors of "The New Work of a Nonprofit Board," *Harvard Business Review*.

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