



Nonprofit *Alert*®

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

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A stunning development has occurred in the ongoing tax dispute between the Indianapolis Baptist Temple (“IBT”) and the IRS. A district court judge has granted an IRS motion to evict IBT from its church property.

Under the court order, IBT must vacate its property, including its sanctuary, by November 14. The church’s pastor and his wife must abandon the parsonage in which they have lived for 32 years.

As reported last month in **Nonprofit Alert**®, the Seventh Circuit Court of Appeals ruled earlier that the IRS may foreclose on IBT’s property to settle tax liabilities outstanding since 1987.

The court said the IRS could collect over \$5 million in Social Security and income taxes that IBT should have withheld from its employees’ wages, despite IBT’s belief that paying taxes violates its religious principles.

IBT is appealing the Seventh Circuit’s ruling to the U.S. Supreme Court, but the district court ruling granting the IRS’s motion for eviction occurred in the meantime.

IBT is defiant. It contends “[t]he issue is the right of a church to exercise and practice its faith in the sovereignty of the ... Lord Jesus Christ in America today without government influence or control.” This saga began in 1984 when the church

the church ordained all employees as ministers, designated their wages as housing allowances, and housing allowance refused to withhold income tax or Social Security taxes from their wages. Under tax law, only “ordained ministers” are

Give Virtually Anywhere: IRS Approves On-Line Donor Advised Fund

The IRS recently approved a charity’s proposal to accept gifts made over the Internet to the charity’s donor advised fund (“DAF”). The charity, Philanthropic Research, Inc. (“PRI”), has established the GuideStar website (www.guidestar.org), which provides an on-line database containing information on the finances and programs of more than 700,000 U.S. nonprofit organizations.

PRI proposes that GuideStar visitors will make gifts to the DAF, then periodically recommend that PRI distribute funds from the DAF to specific charitable beneficiaries. Before accepting a gift, PRI would require donors to acknowledge that gifted funds belong to PRI and are subject to its discretion and control.

Although PRI’s policy would be to follow the suggestions of its donors/advisors, it would only honor recommended gifts to qualified public charities

eligible for exclusion from federal income tax.

➤ **For more information, see *Nonprofit Alert*® Memo, *Ministerial Housing Allowances: Qualifying and Documenting*.**

listed in its database. PRI would not make gifts to individuals or private foundations. If a donor were to recommend a gift to a beneficiary that did not meet PRI’s standards, PRI would ask the donor to make a different recommendation.

The IRS ruled that because PRI would exercise dominion and control over the gifts, they would be counted as assets of PRI. The gifts would be includible in PRI’s public support for purposes of continuing to qualify as a public charity. PRI has not yet launched the proposed DAF.

➤ **As donor-designated giving and DAFs skyrocket in popularity, the IRS continues to carefully scrutinize DAFs and issue new guidance. To help your organization navigate the shoals involved in operating DAFs, see *Nonprofit Alert*® Memo, *Avoiding the Pitfalls of Donor Designated Giving*.**

Liability & Risk Management

Prohibited Play: Children's Wish Foundation

The Children's Wish Foundation, an Atlanta-based nonprofit organization that distributes toys and other gifts to terminally ill children around the world, has been charged with 95 violations of Pennsylvania's charitable solicitation laws. Forty-one of these alleged violations involve misrepresenting the value of in-kind gifts the charity made to other nonprofits. The remaining counts involve improper spending of charitable funds. The charity's co-founders, a husband and wife, allegedly used the charity's credit card to pay for a spending spree of first class flights to Europe, stays in luxury hotels, expensive meals, and Christmas gifts. If found guilty, the charity could face fines up to \$1,000 per violation. The charity has faced similar charges in the past. In 1994, it paid more than \$200,000 to settle a lawsuit by the Connecticut Attorney General alleging that the charity filed financial reports falsely claiming enormous in-kind contributions to other organizations.

 **To prevent these type of abuses, a nonprofit board should have a conflicts of interest policy and be actively engaged in oversight of its officers' activities. Two Nonprofit Alert® Memos, *Conflicts of Interest Policy* and *Directors' Nonprofit Legal Duties*, will help train your board members in understanding and fulfilling their fiduciary responsibilities.**

Bishop Estate Insurer Settles for \$25 Million

The insurance company for the Bishop Estate, the largest charity in Hawaii, has proposed to pay \$25 million to settle a claim filed last year against the charity's trustees by the Hawaii Attorney General. This settlement is contingent on the approval of a probate judge, a court-appointed official, and the IRS. Both the Attorney General and the IRS have accused the Estate's trustees of paying themselves excessive compensation—over \$1 million apiece—and diverting several million dollars of the charity's funds to their own personal business endeavors (*NPA*, Nov'98, Jan'00). A state court judge has already removed the five former trustees, and the charity has agreed to make other structural and management changes requested by the IRS as a condition of retaining exempt status.

 **This brings to a close the long saga of the Bishop Estate Trust, illustrating some of the worst ever examples of private benefit and conflicts of interest by trustees of a public charity.**

FBI Investigates Charity After Executive Resigns

Food For the Poor, a Florida-based charity that provides food and monetary aid to Latin American countries, is under investigation by the FBI following the resignation of the charity's president, Ferdinand Mahfood. Mahfood resigned in September after an internal audit revealed that he had given approximately \$275,000 of the charity's money to two female employees. He and his family have reportedly repaid the money. The charity's board of directors suspended Mahfood six weeks before his resignation, after he admitted his misuse of charity funds. After Mahfood was suspended, the charity allegedly fired or forced several employees to resign for refusing to sign a confidentiality agreement prohibiting them from making "defamatory" statements about the charity. One former employee has filed suit, claiming he was dismissed after he spoke to the local sheriff's office about Mahfood's misdeeds.

 **Proactive implementation of the guidance set forth in Nonprofit Alert® Memo, *Governing Responsibly by Nonprofit Board Members*, could have helped avert some of these problems. See back page to order.**

Employees & Volunteers

Due Diligence Averts Liability in Sexual Abuse Case

The First Church of Christ in Lock Haven, Pennsylvania was sued for negligence in its hiring, supervision, and retention of its former senior minister, who admitted to sexually abusing a seven-year-old girl who attended his church. The girl's parents sued the church, arguing that the church did not completely investigate the minister's background before hiring him. Both a lower state court and an appellate court ruled that the church was not liable for its minister's activities because it had adequately investigated his background. The church had required the minister to complete an extensive questionnaire, interviewed him at length, and discussed his suitability with all 14 references he provided during the hiring process. Although the minister had allegedly engaged in a homosexual relationship while in high school and exposed himself from the window of his previous home, the court found that the church had no duty to inquire about all of the minister's prior sexual conduct. *R.A. v. First Church of Christ and Darran A. Chick*, 2000 PA. Super 58.

 **Child sexual abuse is a growing area of liability for churches and other nonprofits that work with children. Nonprofit Alert® Memo, *Child Abuse: Screening Nonprofit Workers*, addresses screening procedures for nonprofit employees and volunteers.**

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Don't Look Now, But I'm E-avesdropping On You

A group of bipartisan lawmakers has introduced legislation in the House and Senate that would generally prohibit an employer from electronically monitoring its employees' wire, oral, or electronic communications without first giving the employees notice of possible monitoring. The employer would be required to provide this notice to all employees on an annual basis. The notice would have to be "clear and conspicuous" and describe (1) the form of communication that would be monitored; (2) the means by which such monitoring would occur; (3) the frequency of the monitoring; and (4) how information obtained from the monitoring would be stored or used. The bill would allow an employer to conduct electronic monitoring *without notice* if the employer has reasonable grounds to believe the employee is engaged in conduct that would violate the legal rights of the employer or another person and cause significant harm, and if the monitoring would produce evidence of this conduct. The bill is now before the Senate Judiciary Committee (S. 2898) and the House Subcommittee on the Constitution (H.R. 4908).

Tax-Exempt Issues

IRS Need Not Disclose Confidential Donor Records

A recent federal appellate court opinion confirms that the donor records of nonprofit organizations are confidential and not required to be disclosed under the Freedom of Information Act ("FOIA"). In an attempt to secure names of an educational foundation's donors, a law firm sued the IRS under the FOIA.

A federal district court held that FOIA does not require this disclosure (*NPA*, Oct'99), a decision affirmed by the appellate court. Although FOIA requires the government to make its records available to any person, virtually all tax documents are exempted from the law, including the donor information of public charities. *Stanbury Law Firm, P.A. v. Internal Revenue Service*, No. 99-3138 (Aug. 9, 2000).

 **For more information, order Nonprofit Alert®Memo, UBIT Primer for Nonprofits. See ordering information on page 4.**

Charity Watchdog Union: To Merge or Purge?

Two charity watchdog groups, the National Charities Information Bureau (NCIB) and the Philanthropic Advisory Service (PAS) of the Council of Better Business Bureau, plan to merge by year's end, subject to approval of the New York Supreme Court and the District of Columbia. Supporters predict the merger will improve efficiency and effectiveness of philanthropic oversight, enabling more charities to be evaluated and more donors to be reached. Consolidation of the NCIB and PAS evaluation standards may eliminate confusion among charities and donors. Critics, however, fear the merger will cause weakened standards of accountability, particularly regarding accumulation of income. Some critics allege that NCIB and its standards would be practically eliminated. They point out that only one NCIB staff member will stay on after the merger, moving to PAS headquarters. Until the new hybrid announces its evaluation standards, new charity evaluations will be based on PAS guidelines.

NPA Highlight of the Month

Democratic, Republican Platforms Address Nonprofit Concerns

On the eve of the Presidential election, you may be wondering how charities and charitable donors would fare under a President Gore or a President Bush regime. The following are excerpts from the Republican and Democratic Platforms addressing government cooperation with faith-based social service providers, charitable tax deductions, and tax relief for tuition and student loan expenses:

Democratic National Platform 2000 (<http://www.democrats.org/hq/resources/platform>)

- "[I]t is time that government found ways to harness the power of faith-based organizations in tackling social ills such as drug addiction, juvenile violence, and homelessness."
- "[I]n contrast to the Republicans, Democrats believe that partnerships with faith-based organizations should augment—not replace—government programs, should respect First Amendment protections, and should never use taxpayer funds to proselytize or to support discrimination."
- "We should. . . provide grants to community and faith-based organizations to help couples prepare for and strengthen their marriage and relationships, become better parents, and reduce domestic violence."
- "We propose. . . a new National Tuition Savings program to tie together state tuition savings programs in more than 30 states so that parents can save for college tax-free and inflation-free."
- "We propose a tax cut for tuition and fees for post-high school education and training that allows families to choose either a \$10,000 a year tax deduction or a \$2,800 tax credit."

Republican Platform 2000 (<http://www.rnc.org/2000/2000platformcontents>)

- "When government funds privately-operated social, welfare, or educational programs, it must not discriminate against faith-based organizations. . . Their participation should be actively encouraged, and never conditioned upon the covering or removing of religious objects or symbols."
- "The participation of faith-based and community groups will be especially important in dealing with the twin problems of non-marital pregnancy and substance abuse. . . we will encourage faith-based and community organizations to take leading roles in after-school programs that build character and improve behavior."
- "We propose. . . [e]ncourag[ing] an outpouring of giving by extending the current federal charity tax deduction to the 70 percent of all tax filers who do not itemize their deductions and by allowing people to make donations tax-free from their IRAs."

Property Tax Relief For Gift-Sale Donors

The U.S. Tax Court has overruled the IRS, holding that two Texas residents are entitled to take a charitable contribution deduction for selling property to a church for less than fair market value (“FMV”) and retaining legal title until the church paid off the property. The court held that the taxpayers could take a deduction for the difference between the property’s FMV (\$450,000) and the sales price they received from the church (\$152,000) in 1994. The IRS claimed that the taxpayers had not made a completed gift of the property, since they kept legal title to the property until the church made its final payment in 1997. The court disagreed, and concluded that the “bundle of rights” the church received upon sale was essentially the same as it would have received had title been conveyed upon sale. *Musgrave v. Commissioner of Internal Revenue*, T.C. Memo. 2000-285.

 Under tax law, a taxpayer who makes a “bargain (gift) sale” to a charity by selling the property for less than the property’s FMV is generally entitled to a charitable deduction for the difference between the FMV and the sales price. For more information, order the new Nonprofit Alert®

Supreme Court Leaves Utah Fundraising Law Intact

The United States Supreme Court has decided not to hear an appeal involving Utah’s charitable solicitation act, leaving intact a Tenth Circuit Court of Appeals ruling that upheld parts of the law and invalidated others as unconstitutional (*NPA*, Mar’00). The ruling struck down a Utah requirement that professional solicitors must post a \$25,000 bond, on the grounds that this was an unconstitutional restriction on speech protected under the First Amendment. The court upheld other provisions of the law, however, including requirements that fundraising consultants must obtain a state license, file annual financial disclosures, and pay an annual registration fee of \$250.

 Similar legal challenges to fundraising laws are proceeding in Pinellas County, Florida, Jefferson County, Kentucky, and other state and local jurisdictions. See Nonprofit Alert® Memo, *Charitable Solicitation Laws: A Multi-State Summary*, for an overview of state fundraising restrictions and registration requirements.

State Rules & Regs

Sun Shines on School Vouchers in Florida

In the continuing school voucher saga, a Florida Court of Appeals has upheld Florida’s statewide school voucher program. The voucher struggle began in 1999, when Gov. Jeb Bush approved a bill providing that parents whose children attend substandard public schools may send their children to private schools using state-funded vouchers. A lower court ruled that the program was unconstitutional, but the appellate court overturned this ruling last month. Voucher opponents plan to appeal to the Florida Supreme Court. Meanwhile, over 50 children participate in the program and receive vouchers worth \$3,000-\$4,000.

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