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Nonprofit *Alert*®

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

Inside This Issue:

HHS Awards $30 Million in Grants to Faith and Community Based Groups

Nonprofits received over $30 million in federal funds last month through a new program intended to level the playing field for faith and community based groups, the Department of Health and Human Services announced.

President's Centerpiece

Known as the Compassion Capital Fund (CCF), the program is a centerpiece of Pres. Bush's plan to help these groups better deliver critical social services. It targets faith and community based organizations because they have historically been disadvantaged when applying for federal funding.

Such groups often lack the professional expertise or the manpower to successfully navigate the bureaucratic maze of federal funds. Many organizations—particularly smaller groups—also lack a clear understanding of what funds they're eligible to receive.

Congress funded the CCF earlier this year, making it the first federal funds program specifically targeted to assist faith and community based grassroots organizations.

Priority for funding is given to organizations that focus on homelessness, hunger, at-risk children, transition from welfare to work, and those in need of intensive rehabilitation such as addicts or prisoners. CCF funds may not be used to support religious practices such as worship, prayer, or religious instruction.

Diverse Recipients

The list of grant recipients includes Catholic Charities of Central New Mexico, the Christian Community Health Fellowship, Operation Blessing International, and the Mennonite Economic Development Associates. HHS said grant recipients represent a wide range of organizations that assist a diverse group of organizational and religious affiliations.

More Next Year

For fiscal year 2003, Pres. Bush has requested $100 million to fund the CCF and to expand support for faith and community based groups. This means considerably more in federal funds could be available for next year's round of grants.

Based on the program schedule from this past year, an announcement of grant availability and application information is published in the *Federal Register* in June, with awards being made in the fall.

More details about the CCF program are available at http://www.hhs.gov/fbci/.

Avoiding Scandal: Measuring Accountability in Nonprofits

Seventy-three percent of religious organizations and 48% of other charities adhere to a formal statement of moral and ethical beliefs in selecting board members and carrying out their missions, according to a new study by Independent Sector. The study is the first of its kind to measure accountabililty and ethics in nonprofits.

Interestingly, the study found 61% of charities rely on independent parties to assess their activities, but only 38% of religious groups do. That may be partly because religious groups are rarely asked to evaluate their activities, the study suggests. Since most churches have direct membership accountability built into their organizational documents, they may not identify a need for independent evaluation.

But given the increasing notority of charitable scams and scandals, perhaps religious organizations should be more concerned. The study, *Balancing the Scales: Measuring the Roles & Contributions of Nonprofit & Religious Congregations,* is available at www.Independent Sector.org.

Liability & Risk Management

Indemnification Clause Makes Nonprofit Liable for School Board's Negligence in Molestation Case

The Louisiana Supreme Court has ruled that a nonprofit agency must indemnify a public school board for the board's own negligence where the agency provided a trainer who allegedly molested two public school students. Lighthouse for the Blind of New Orleans contracted with the Orleans Parish School Board to offer mobility training in the public schools. The contract included a boilerplate indemnity clause saying Lighthouse would "indemnify, hold harmless, and defend the school board" against all claims arising from the performance of services under the contract. The parents of two students, allegedly molested by a Lighthouse trainer, sued Lighthouse and the school board for failure to supervise, failure to provide a safe environment, failure to investigate reported complaints, and failure to conduct background checks. Lighthouse refused to indemnify the board, arguing that the board's negligent supervision allowed the molestation to occur. But the court rejected that argument and found the contract clearly required indemnification, regardless of whether the board's negligence caused the damage. The court said it was the Lighthouse employee whose misconduct led to the negligence claims; therefore, the injury would not have occurred except for Lighthouse's negligent performance under the contract. *Berry v. Orleans Parish Sch. Bd.,* No. 2001-CC-3283 (Sup.Ct. La. 2002).

Beware of "boilerplate" contract clauses. . .

Beware of all "boilerplate" contract clauses, particularly ones that attempt to shift risk to your organization. Most general liability policies do not ordinarily cover indemnification or other contractually assumed claims. If you cannot avoid extending indemnification, then contact your insurance carrier to verify adequate coverage of contractually-assumed liabilities.

Cosmic Disharmony Leads to Church Settlement

A heated dispute between spiritualists and Christians over construction of a church has finally settled after two years of legal wrangling. The spiritualists own a 55-acre camp, founded in 1875, near the town of Cassadaga just outside Orlando, Fla. Dunamis Community and Outreach Ministries wanted to build a church in the same town, but the spiritualists opposed construction because they feared it would "disrupt the cosmic harmony and vibrations of the town." They petitioned the county council to reject the church. When the council voted against the church, its organizers filed a federal lawsuit, arguing violations of the Religious Land Use and Institutionalized Persons Act (RLUIPA) and the First Amendment. Now, both sides have reached an agreement that permits construction of the church but requires organizers to re-petition if they plan to build other facilities or offer services to drug addicts or convicts (part of the church's ministry involves work with those individuals). *Dunamis Comm & Outreach Ministry v. Volusia County Council,* No. 01-CV-643-ORL-28-DAB (M.D. Fla.).

RLUIPA was enacted to protect religious exercise from being trumped by zoning and other land use regulations. Under RLUIPA, a government is prohibited from imposing zoning regulations that create a substantial burden on the exercise of religion, unless the government can demonstrate that the regulation (1) furthers a compelling government interest; and (2) is the least restrictive means of furthering that interest.

Employees & Volunteers

The Missing Link: 2nd Circuit Delineates Employer Liability for Supervisor's Harassment

The question of whether an employer is liable for a supervisor's harassment depends on whether tangible job benefits are linked to the harassment, the 2nd Circuit Court of Appeals says. The case involved a female employee of MetLife Insurance Company who claimed she was repeatedly harassed by her supervisor. The harassment allegedly included crude remarks, offensive touching, sexual advances, and threats of physical harm. The employee complained to management, but when the supervisor found out, he withheld her paychecks. He then ordered her to attend meetings with him at night, but she refused and was eventually fired. She brought suit under Title VII, claiming sexual harassment. The trial court ruled she had indeed been harassed but suffered "no tangible adverse action" and, therefore, excused MetLife of any liability for the supervisor's behavior. On appeal, the 2nd Circuit reversed, saying the lower court defined "tangible adverse action" too narrowly because it should have included the adverse actions of withholding the employee's paychecks and the supervisor's demands for sexual favors in return for her continued employment. MetLife empowered the supervisor, the court noted, and gave him

Employer liability depends on "tangible adverse job action."

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authority to control employees. Because the supervisor acted as MetLife's agent in carrying out those duties, MetLife was strictly liable for his behavior, the court said. *Jin v. Metropolitan Life Ins. Co.,* 2002 WL 1394348 (2nd Cir. 2002).

Analysis of the employee's response, whether she submitted to the sexual advances or not, misses the question entirely, the court said. Instead, it's the employer who should shoulder liability because the employer is in the best position to screen, train, and monitor supervisors to prevent harassment. If your organization does not have a published harassment policy, or has not recently updated it, order Nonprofit Alert® Memo, *Sexual Harassment Policy: Implement & Educate.* See back page to order.

Census Bureau Surveys Americans on Volunteerism

The Census Bureau, in cooperation with the USA Freedom Corp., just completed a comprehensive national survey of some 60,000 American households to assess various indicators of volunteer activity. The survey collected data on labor force issues, but also included questions designed to measure how Americans volunteer, how often, the kinds of organizations where they volunteer, and the types of activities they choose. Additional questions addressed those who don't volunteer and asked what could be done to remove barriers or make it easier to volunteer. It's been more than 13 years since this much data was collected on American volunteers. The Census Bureau now plans to conduct the survey again in September 2003 and subsequent years if funding is available.

Since this survey provides a benchmark for volunteer profiles and trends, its results could be useful to organizations in planning and recruiting volunteers. Find out more about the survey at www.usafreedomcorps.gov. If your organization has not recently reviewed and updated your volunteer program and policies, see Nonprofit Alert® Memo *Managing Volunteers: Risks & Rewards*. See back page for ordering instructions.

Tax-Exempt Issues

Church's Property Sale Avoids UBIT. . . For Now

The IRS has approved a church's plan to sell certain property without incurring unrelated business income tax (UBIT), but it has reserved judgment on a particular aspect of the sale agreement that could create future tax implications. The church owned a parcel of land on which it operated worship facilities and a school. The land had never been developed or used to produce income; it had only been used in conjunction with the church's charitable activities. When the school needed a new gym, the church mortgaged the property and used the funds to begin construction. Additional funds were needed, so the church sold a parcel of its land. The buyer agreed to compensate the church in a three-tiered arrangement: 1) cash at closing; 2) a promissory note for an additional amount, secured by a mortgage on the parcel; and 3) a

NPA Highlight of the Month

Foundation May Pay Premiums on Donor's Insurance

The IRS has given the go-ahead to a private foundation that wanted to accept a donor's term life insurance as a contribution and take on responsibility for making premium payments on that policy. Donations of life insurance are not uncommon, but the interesting aspect of this ruling is that the IRS gave approval to the foundation's plan to pay all premiums on the policy.

The arrangement consisted of an irrevocable trust, established by the founder of the private foundation. The trust proposed transferring ownership of the founder's term life insurance policy to the foundation, which the foundation agreed to accept, upon certain conditions. Among those conditions, the policy would be changed to reflect the foundation as sole beneficiary. The founder also agreed to make a written promise granting annual contributions to the foundation in amounts that would cover the cost of all premiums left to be paid on the insurance policy. Most importantly, the founder agreed to execute an irrevocable voting proxy giving one of the foundation's board members all his voting rights in order to insure the founder would no longer control any aspect of the insurance policy or any decisions affecting the policy.

Reviewing the arrangement in total with all the proposed limitations on the founder's control, the IRS approved the plan. The IRS said the foundation would not engage in self-dealing by accepting the proposed donation nor by accepting the founder's guaranteed contributions meant to cover the payment of premiums.

The arrangement as presented was free of encumbrances on the foundation and did not constitute an extension of credit, the IRS noted. Because the foundation would gain complete control and ownership of the insurance policy, the IRS concluded that the foundation would not risk private benefit or endanger its exempt status by making the premium payments on the policy. IRS LTR

Complicated split-interest gifts don't often pass IRS scrutiny because of potential private benefit. Here, the key to a favorable ruling was that no actual split interests were created, leaving the foundation with full control. Because the arrangement had been carefully constructed to give complete control and ownership to the foundation, the IRS was willing to grant approval.

percentage of the net profits from any improvements the buyer makes to the property. The IRS reviewed the plan and approved the first two tiers of the arrangement, saying they presented no UBIT consequences for the church because those proceeds constituted gains on the property. Since the church did not engage in any activities associated with real estate development, never made any improvements to the property, nor advertise or solicit bid for its development, the IRS said the sale was not one occurring in the ordinary course of business that would trigger tax concerns. As for the third tier of the arrangement, however, the IRS refused to grant an opinion, noting only that the issue would be the subject of future correspondence to the church. IRS LTR 200237027.

Factors that the IRS considers when determining whether property is sold in the ordinary course of business are: 1) purpose for which property was acquired and held; 2) frequency, continuity, and size of sales; 3) extent of improvements; and 4) proximity of purchase and sale.

Grant Money Finds Suitable Home After Merger

This is the tale of three entities: the foundation, the corporation and the association. All three existed happily for a time with similar missions to promote the administration of justice. The association operated on contributions from members. The corporation operated on grants from the foundation. But times changed, and funds dwindled. To improve their situation, the association and corporation struck a compromise. The corporation dissolved, and the association took on all the charitable legal education programs the corporation sponsored.

But the association wanted all the grant money too, and that's where the tale turns sour. The foundation's bylaws prohibited it from supporting anything other than a 501(c)(3). The association operated as a 501(c)(6) business league, which made it ineligible to receive the foundation's grants. Without the grant money, however, the association couldn't continue the now defunct corporation's programs. So, the foundation offered to change its bylaws and continue granting to the association on the condition that the association would keep all grant funds in separate accounts. That way, the foundation could be certain the grant money was used exclusively for the legal education programs that the foundation originally supported. The association would provide annual reports to the foundation detailing the use of all grant money. Any unused grants would return to the foundation, and all grants would be subject to approval by the foundation's board. The IRS approved this arrangement and cleared it of tax problems. The foundation would not endanger its exempt status by making grants to the association, so long as all the prescribed limitations were in place, the IRS concluded. IRS LTR 200234071.

Ordering Information: Memos referenced in the ***Nonprofit Alert*** can be purchased for $20 each ($10 for firm clients) from Gammon & Grange, P.C. Five or more copies of the same memo are bulk priced at $5 each. Call, write, or email us at the address below.
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