



Nonprofit *Alert*®

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

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Nonprofit Overview

PTA Partners With OfficeDepot

Nonprofit Endorsement Deal Raises Questions

The National PTA drew criticism last month from many of its 6.5 million members when it announced an endorsement arrangement with OfficeDepot. For an undisclosed sum, the PTA sold rights to use its name and logo in a back-to-school promotion that OfficeDepot launched in late August. The deal also gives OfficeDepot rights to bill itself as “the official school supply headquarters of the National PTA.” Many PTA members and leaders objected to the organization’s participation in something so excessively commercial. In over 100 years of existence as a national educational nonprofit, the PTA has never permitted its name or logo to be used for any commercialization, primarily because its bylaws forbid such endorsements.

★ **However, PTA officials justified the current arrangement as a “member benefit” because it also calls for OfficeDepot to donate laptop computers to state PTA offices and mail discount coupon booklets to PTA members. In addition to the backlash from members, deals like this often grab IRS attention because they generate a potential plethora of tax issues from insider deals to UBIT concerns—none that can be taken lightly because of their risk for long-term damage.**

Court Upholds Registration Law on Fundraisers

A federal court says Utah may apply a strict law against out-of-state fundraising consultants requiring them to register and maintain a large bond or letter of credit. The case involved Judicial Watch, a conservative Washington, DC group, that hired American Target Advertising (ATA) to conduct its direct mail campaign in Utah. When Justice Watch filed for solicitation in Utah, the state insisted that ATA register as well. ATA objected, arguing a violation of free speech and due process because the law was not “narrowly tailored” to protect the public without infringing on the rights of charities. A federal judge rejected the argument, finding the law “acts as a deterrent to fraudulent activity” and “provides a fund from which victims can draw in the event that they are defrauded by charitable solicitors.”

★ **The case is on appeal to the 10th Circuit. Meanwhile, nonprofits nationwide are watching the case because it could determine the constitutionality of charitable solicitation requirements in a number of states. A finding for ATA could alter the restrictions now imposed on state charitable solicitations, relaxing many of the rules governing everything from door-to-door fund raising to direct mail campaigns.**

GAMMON & GRANGE, P.C.

welcomes as Counsel to the firm:

James K. Lockett

Mr. Lockett comes to Gammon & Grange from Brussels, where he was a partner in a leading international law firm and vice-president of the International Christian Chamber of Commerce. He brings to the firm over 17 years of experience in international and business law for commercial and nonprofit enterprises.

Liability & Risk Management

Serving Two Masters: A Situation Ripe for Conflict.

The IRS has launched an investigation of the former chairman of two exempt Colorado organizations because of possible conflicts of interest. The chairman simultaneously directed both the Independence Institute and Coloradans for School Choice for an 11-month period. Holding both positions doesn't trigger any violations, but the IRS claims the chairman instructed the Institute to donate \$84,000 to the School Choice group. The chairman's influence and control over the Institute makes him a disqualified person, who is prohibited from entering transactions that would benefit himself either directly or indirectly, argues the IRS. The IRS is also investigating possible intermediate sanctions violations, which may have resulted in an insider transaction that led to an excessive benefit for the chairman.

★ **Executives should avoid conflicts like this by fully disclosing their relationships, removing themselves from discussion or votes on issues that involve personal interests, and absolutely avoiding arrangements that produce personal benefit at the organization's expense. As a minimum, nonprofit organizations should implement and enforce an effective conflicts of interest policy.**

➔ **Review the sample policy adaptable to your organization in NP9110-3, *Conflicts of Interest Policy and Resolution*. See back page to order.**

Charity Exec Collects \$1.5M Defamation Award.

A Korean-American community activist won \$1.5 million in damages last month against *The Korea Times*, a Washington, D.C.-based newspaper, which ran an article that falsely accused him of misusing funds. Sunny Kim, president of the Korean Senior Citizens Association in Richmond, VA obtained a large state grant for the association in 1995. Upon complaints from former association members, the newspaper began investigating Kim and his use of the grant money. When he refused to release the association's financial statements, the newspaper ran an article accusing him of embezzlement in 1997. Audits proved the story was incorrect, but the newspaper would not print an apology nor retraction, which led Kim to sue for defamation. *Kim v. The Korea Times*, 13 VLW 433 (Va.Cir. Ct. 1998).

★ **A word of caution: this case is more the exception than the rule. Most cases of this type end in undesirable, or at the**

least, embarrassing outcomes for nonprofits and/or their executives. Full disclosure usually circumvents these problems, and it can be even more effective when coupled with good media relations.

Board Member Faces Criminal Charges for Bids.

The Connecticut Attorney General has filed a civil suit against a former board member of the Hartford Neighborhood Center, a well-established children's charity in existence for over 125 years. An investigation is also ongoing into possible criminal misconduct stemming from over \$700,000 in "no-bid" contracts awarded to a local building contractor. The lawsuit alleges that a former board member took control of all the organization's capital improvement projects in 1995, then awarded practically all the contracts to a local contractor. The contractor's work has turned up unfinished, shoddy, or even uninitiated in some cases, according to the *Hartford Courant*. The suit seeks restitution of the funds from both the board member and the contractor.

★ **A spokesperson for the attorney general says all the board members who served between 1995 to 1997 may face eventual investigation for allegedly giving one member such unlimited and unchecked control over the organization's spending. The member also reportedly had access to the group's endowment fund without any internal oversight or control.**

➔ **Proper financial controls and board policies could help prevent such abuses in your organization. Find guidance in NP9107-1, *Responsible Governance by Nonprofit Board Members*, and NP9106-2, *Accounting & Fiduciary Guidelines for Nonprofits*.**

Employees & Volunteers

Harassment Leads to Retaliatory Discharge Claim.

A federal court has found a nonprofit coalition for the homeless liable for wrongfully discharging an office manager who claimed she was sexually harassed by her supervisor. When she complained about his conduct, she was fired. She then brought suit against the coalition for retaliatory discharge. The state supreme court upheld the trial court's finding and ruled against the coalition for firing the manager in retaliation for her expression against an unlawful practice. *Williamson v. Green*, 490 S.E.2d 23 (1997).

➔ **A proper response to a case like this calls for clearly stated employer procedures to handle employee concerns. Harassment complaints should trigger immediate action, such as an investigation, and reassignment or suspension of the alleged offender pending investigation under some circumstances. More complete details are outlined in NP9201-2, *Sexual Harassment Policy for Nonprofit Employers*.**

Transportation Benefits Offer Nice Tax Break. The Transportation Equity Act, signed into law this past summer,

Nonprofit Alert®

8280 Greensboro Drive, 7th Floor, McLean, VA 22102-3807

(703) 761-5000 Facsimile: (703) 761-5023

E-mail: npa@gandglaw.com

Editor-in-Chief George R. Grange, II

Editor Sarah J. Schmidt

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offers a transportation-related employee benefit that may help nonprofit employees. The law keeps fringe benefits for parking and transit passes and gives employees the option of cash in lieu of these benefits. However, employees can lower their taxes if they elect the benefits since the entire amount of benefits is excluded from wages. Electing cash will, of course, produce taxable income. P.L. No. 105-178, 112 Stat. 107.

★ **Any nonprofit may include transportation benefits in employee compensation packages, but the tax break is most attractive to employees of nonprofits located in metro areas where public transportation is readily available.**

Tax-Exempt Issues

No Gain, No Pain: Couple Avoids Inurement. A radio talk show host and his wife purchased real estate in which to house the headquarters of an exempt educational organization that sponsored their talk show. The organization currently rents the property from the couple and pays for various renovations. As part of the arrangement, the couple agreed to give the organization any gains they realize on the sale of the property. The IRS says this agreement makes the arrangement acceptable, since there can be no private inurement to the couple if they

relinquish all gains to the educational organization. IRS LTR 9835003.

★ **Although this sounds like a simple solution, it may not work in every situation. Tax avoidance arrangements like this are very fact specific and, following new rules on private inurement, usually require tax counsel review and advice.**

➔ **Your organization can take several steps to prevent private inurement, as detailed in NP9109-4, *Essential Don'ts of Private Inurement*, which includes new updates on intermediate sanctions.**

Conference Center's Meals Subject to Tax. The Wisconsin Tax Appeals Commission says a nonprofit conference center, operated by the American Baptist Assembly, must pay sales tax on meals it sells to conference attendees. The department of revenue claimed the Assembly was a "retailer" because it held a state seller's permit, but the Assembly argued state law required it to hold a seller's permit to operate the facility. Because the Assembly collected substantial sums from the sale of meals (\$4.8 million in one year alone) and because it actively advertised the conference center, the Commission decided the sales were intended for profit, making the Assembly a retailer subject to sales tax. *American Baptist Assembly Inc. v. Dept. of Revenue*, 7/27/98.

★ **Tax officials at federal and state levels routinely question profit incentives to determine if exemptions are appropriate. The greater the profit, the more likely it'll generate questions.**

NPA Highlight of the Month

Amid Controversy and Criticism,

AICPA Changes Fundraising Allocations

Since last spring when the American Institute of Certified Public Accountants (AICPA) released its newly Statement of Position (SOP) 98-2, much controversy has been brewing over allocations of fundraising costs. SOP 98-2 dramatically alters the current practice of fact-based, proportional allocation of joint costs between programs and fundraising activities. The eye of the storm centers around the requirement that all costs associated with joint activities shall be reported as fundraising costs, *including* those that might otherwise have been considered program, management, or general costs if they were associated with a different activity that had no fundraising component. The current standard, and the one most nonprofits have operated under for decades, permits all circumstances connected with an activity to be considered when determining how to allocate costs. This new statement significantly limits that flexibility. In fact, experts say the statement is so strict that a mailing, which devotes 99% of its text to education or other charitable purposes, would be counted entirely as fundraising costs if the mailing is sent primarily to donors of your organization. Nonprofits argue SOP 98-2 forces them to account and report numbers that are skewed from the reality of their programming, exaggerating fundraising costs in relation to their program costs. Despite criticism, the AICPA has not wavered from its insistence on this new standard. It is set to take effect for fiscal years starting on or after December 15, 1998.

★ **Nonprofits are taking a long, hard look at how this new standard will change their financial statements and how those changes may be interpreted by potential donors, regulatory agencies, and the general public. The most significant backlash could come from those individuals and organizations that judge or rank nonprofits according to their fundraising costs as a percentage of total expenditures.**

➔ **Two such rankings are now available on the Internet, which makes nonprofits even more nervous about the proliferation of such data to a general public that may not understand the intricacies of these accounting standards. One well-known site, operated by GuideStar, is accessible at: www.guidestar.org. Another, operated by the New York Attorney General, is accessible at: www.oag.state.ny.us/moneymatters/charities/pennies98/intro98.html.**

 **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.**

Loose Lips Sink Ships—And Charitable Deductions.

Taxpayer Barry John Sergeant not only lost a significant tax deduction when a recent Tax Court decision rejected the valuation he submitted for a donated boat, he also suffered an additional 20% penalty because his valuation was more than 200% inflated. The case centered on a badly deteriorated Trojan Motor Yacht that Sergeant bought for \$8,500, then restored and donated a year later to a charity in Maine. Sergeant reported a \$75,100 charitable deduction for the boat, supported by an appraisal using figures from the BUC Guide, a listing of used boat prices and values. The IRS challenged the deduction, and assessed the boat's value at only \$22,125. The Tax Court agreed, finding that the BUC Guide "inflates the value of used boats." It further imposes an additional penalty on Sergeant for inflating the boat's value, citing the appraisal as undated and unprofessional. *Sergeant et ux. v. Commissioner*, T.C. Memo 1998-265.

 **California recently cracked down on donors' inflated deductions for gifts of cars, boats and airplanes. Other states may follow. Caution your donors that the IRS requires qualified appraisals on all non-cash donations with a claimed value exceeding \$5,000.**

State Rules & Regs

Georgia Raises Threshold for Independent Review.

The threshold has been raised from \$500,000 to \$1 million for charities required to have independent CPA's prepare or review their financial statements when conducting fundraising in Georgia. The increase took effect earlier this year. H.B. 1143.

Oklahoma Adds Genetic Discrimination to Statutes.

A state law, effective this summer, prohibits workplace discrimination on the basis of genetic testing or information, except for insurance coverage or benefits. Employers may not seek genetic information or require genetic testing of employees or prospective applicants. Okla.Stat. Ann. §3614.2, 3614.3.

Quote of the Month. "IF YOU PAY PEANUTS, YOU GET MONKEYS. NEVER LET ANYONE THINK THAT WHAT YOUR ARE DOING IS ANY LESS VALUABLE THAN WHAT PEOPLE IN THE FOR-PROFIT WORLD DO." — Barbara Gross, Development Director, Menorah Park Center for the Aging, commenting on issues of reasonable compensation for nonprofit employees and executives.

Hold On Just A Minute! The average executive spends 17 minutes on telephone hold every day, up from 15 minutes in 1993, according to a nationwide survey by OfficeTeam. Although voice mail improves communication efficiency overall, the study faults the labyrinth of options that often precede voice mail boxes as the main culprit in extending callers' time on hold.

 **Take a cue from the study: keep your office answering messages and options to a minimum. Give your callers an immediate option for an operator. They'll think better of you and your organization.**

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Richard M. Campanelli
Stephen M. Clarke
A. ay Fitch III
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* of Counsel

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7th Floor, 8280 Greensboro Drive, McLean, VA 22102-3807

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