



Nonprofit *Alert*®

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

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➤ FLSA Liability

Employees-Turned-Volunteers Can't Claim Overtime Pay, Appeals Court Rules

Nonprofits rarely consider paying their volunteers, since that would be inconsistent with the underlying purposes of volunteerism. But what happens if volunteers demand some form of remuneration? Here's a worst-case scenario:

Seven firefighters, all employed by the City of Virginia Beach, volunteered on a local rescue squad, helping with emergency medical and transport services. Some of the seven were volunteers before joining the fire department,

but others did not volunteer until after becoming firefighters. In each case, however, the firefighters individually and of their own volition chose to volunteer. Neither the city nor the fire department pressured them to volunteer or qualify for various medical certifications needed to join the rescue squad. The firefighters testified that their motivation was purely humanitarian. After several years, the city created a special department to oversee and coordinate all rescue units within its jurisdiction. The firefighters argued that creation of this new department effectively brought their volunteer activities under the city's supervision, so they sued for overtime pay under the Fair Labor Standards Act (FLSA).

They claimed their volunteer work should be compensated. Although they didn't contend that the city actually "controlled" their volunteer work, they claimed that mere oversight by the new department made them "employees" under FLSA because their services benefited the city. Not so, said the court, since their rescue work lacked the an employer-employee relationship.

"After making the independent decision to volunteer their services, plaintiffs have apparently changed their minds, believing the City should compensate them for these services. It is clear, however, that they have no remedy in the FLSA for this change of heart. Rather they have a choice—...they may resign."

— *Judge William B. Traxler writing for the majority in Beshoff v. City of Virginia Beach.*

The city did not coerce or control the firefighter's volunteer work; there was insufficient day-to-day involvement in their volunteer work to classify them as "employees;" and the firefighters set their own volunteer schedules and positions with only minimal coordination from the city. Because of these factors, the court ruled their

volunteer work could not be compensated. *Beshoff v. City of Virginia Beach*, 1999 WL 371592 (4th Cir., 1999).

~~~ Benefit For Our Readers: Free Nonprofit Alert Memo ~~~

Gammon & Grange has overstocked **Nonprofit Alert**® Memo 9612-1, *Legal Hot Spots for Churches*, but now you can benefit from our mistake. While supplies last, we're giving away copies of this popular memo with the purchase of any other **Nonprofit Alert**® Memo.

Select from a list of over 60 titles, covering timely topics on the organization & administration of nonprofits, taxes & fundraising, and other legal risks. Call for a free list of all the memos we offer.

Liability & Risk Management

Duty to Report Child Abuse Averts Defamation

A pastoral counselor, who worked for a church-based counseling center, successfully defended a defamation claim brought by the father of four children she counseled, by relying on a state law that required her to report any suspicion of child abuse to the proper authorities. The counselor first met the children's mother when she sought counseling services, and after several months, concluded that she had been the victim of marital abuse. She then began counseling the children, who also showed signs of abuse. After five months with the children, the counselor prepared a written report describing various behavioral problems each child displayed. The report also referred to medical reports that evidenced sexual and physical abuse. Based on her observations and medical reports, the counselor concluded all four children had been abused. She then telephoned her conclusion to military police at Fort Benning, where the father was employed. The father argued this constituted defamation. However, state law required anyone to report abuse if they had "reason to believe that a child is a victim of child abuse or neglect." The court noted, "The duty to report is absolute and applies to *all* persons." Because this covered the counselor, she could not be liable for defamation arising from her report to military authorities. *Aylward v. Bamberg*, 1999 U.S.App.LEXIS 15168 (7th Cir. 1999).

➔ **All states have some form of child abuse reporting laws, and most impose mandatory reporting duties on day care providers, counselors, and even volunteers who work with children. Be sure you, your employees, and volunteers know these duties. For help, order Nonprofit Alert® Memos 9611-2, State Child Abuse Reporting Laws, and 9611-3, Responding to Indications of Child Abuse. Also inquire about Gammon & Grange's other memos related to the prevention of child abuse.**

Church 'Missed the Bus' on Transportation Contract

When the Tennessee Department of Human Services (DHS) needed transportation for clients participating in a governmental program, it turned to a local church. DHS offered the church \$7 per day for every client who used the church-provided transportation, starting with only 45 clients but increasing to an

estimated 300 once the program developed. The church considered the offer, researched the program, formed a budget, negotiated with DHS, and leased four buses. At no time, however, did DHS tell the church that the program also reimbursed clients \$5 per day if they used their own transportation. Once the program began, few clients used the buses, opting for their own transportation instead and collecting the \$5 payments. The church lost \$18,000 in revenues as a result and filed suit, claiming DHS made false representations by not disclosing the \$5 payments to clients. A trial court agreed with the church, but an appeals court overturned the ruling and found DHS had no duty to disclose. The appeals court said such duty arises "only when there's a fiduciary relationship..., or when one party has expressly reposed trust and confidence in the other, or when the contract itself is intrinsically fiduciary and calls for perfect good faith." None of those conditions existed in this case, the court decided, so the church could not recover its losses. *Admin. Bd. for First United Meth. Church of Tracy City, Tenn. v. Tenn. Dept. of Human Serv.*, 1999 Tenn.App. LEXIS 264 (Tenn.Ct.App. 1999).

➔ **Because the \$5 client payments were readily discoverable public knowledge, the appeals court was unsympathetic to the church's argument. A standard warranty and representations provision in the contract would likely have led to a different result, however.**

Employees & Volunteers

Home Sweet Home? Not for Salesman/Minister

Even before the advent of telecommuting, the IRS traditionally recognized insurance agents as one of the professional classes that actually worked from home on many occasions, and were thus entitled to the home office deduction. In this case, however, the IRS denied the deduction to an insurance agent who also worked as a part-time minister because his home was not his "principal place of business" for either vocation. The insurance company did not provide him an office nor require him to be present at headquarters. He also did not have a designated office as a minister. Instead, he worked as chaplain in a mobile home community and sometimes taught at local churches. Although he regularly drafted insurance papers for clients and prepared sermons at his home, the IRS noted that his insurance deals were always consummated at the home or office of clients, while his sermons were always delivered in the mobile home community or in a church building. Since the delivery point for both services was outside his home, the IRS ruled him ineligible for the home office deduction, and the Tax Court affirmed. Any preparatory work he conducted in his home for either vocation was merely secondary to the final delivery of services, the court said. *Strohmaier v. Commr.*, 113 T.C. No. 5 (8/3/99).

➔ **Can your employees qualify for a home office deduction? Does their arrangement, like the salesman/minister's, fall short of qualifying? Nonprofit Alert® Memo 9412-1, The Home Office Deduction for Nonprofit Workers helps answer these questions. See back page to order.**

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Until Death . . . or Discrimination . . . Do Us Part

The Age Discrimination in Employment Act (ADEA) provides no recovery to the spouse of an employee who allegedly suffered age discrimination, although the employee herself may seek recovery under the act, says the Second Circuit. In what would seem to be a common sense approach to the ADEA, the court denied claims asserted by the husband of a woman who filed for age discrimination against her employer. The husband claimed he suffered loss of consortium and personal injuries as a result of the stress his wife endured during the course of her discrimination case. The court said an ADEA claim must be based on an employee-employer relationship, which the ~~husband clearly did not have in this case~~ *Loss v. Stinnes Corp.*, 169 F.3d 784 (2nd Cir. 1999).

Tax-Exempt Issues

Post-Bankruptcy Conversion Doesn't Save Donors

Religious doctrine may say it doesn't matter when an individual "finds God," but the Bankruptcy Court says it is most certainly an issue of timing. After taxpayers James and Jean Smihula filed for bankruptcy, they submitted an amended schedule showing \$700 per month in charitable contributions. Their earlier filing made no provision for charitable contributions, nor did they offer evidence of any previous giving. In court, the Smihula's actually admitted they preferred to dispose of their assets by giving them to charity rather than paying off creditors. They argued that federal law protects contributions that donors make before bankruptcy and, therefore, should also apply *after* bankruptcy. It was

discriminatory, they claimed, for federal bankruptcy laws to protect the contributions of donors who "found God" before bankruptcy but not those of donors who "found God" after bankruptcy. The court was unconvinced, however, ruling that debtors must establish a history of charitable giving when their bankruptcy petition is filed, not afterwards. *In re Smihula, U.S. Bankruptcy Ct. for the District of Rhode Island*, 83 AFTR 2d par. 99-889; No. 98-13949 (1999).

 **The Religious Liberty and Charitable Donation Protection Act of 1998 protects charitable giving if there's a clear trend reflected in the donor's activity before bankruptcy. (NPA, July '98). But that law doesn't apply after bankruptcy. The reason: religious and charitable organizations would potentially have to return donations if they're received from donors who later declare bankruptcy. Extending the protections to debtors who have no history of charitable giving would create a loophole allowing debtors to give away assets rather than pay creditors.**

Nonprofit Indemnifying For-Profit — Still Exempt

The IRS has ruled that an indemnification agreement made when a health insurance corporation re-organized itself into an exempt foundation, will not jeopardize the exempt status of the foundation. The foundation was formed after Blue Cross/Blue Shield merged into a nonprofit organization in 1985 and later became a for-profit corporation in 1995 when state laws changed to permit the conversion. When the state challenged the

NPA Highlight of the Month

Charity Protected From Disclosing Contributors

The IRS isn't obligated to disclose the names and addresses of donors to a public charity, nor the amounts of their contributions, says a federal district court, enforcing a long-established provision of the tax code and giving heightened attention to new disclosure rules that just took effect this year. The case arose when a law firm attempted to obtain a list of donors from the Page Education Foundation. The firm requested not only the donors' names, but their addresses, amounts of donations, and other identifying information. The charity did not respond, prompting the firm to file a Freedom of Information Act (FOIA) request with the IRS. The firm attempted to obtain the same information from the IRS's tax files. When the IRS didn't respond, the firm then filed suit seeking a court order that would force the IRS to release the requested information. Under §6104 of the tax code, annual information returns (commonly called the Form 990) filed by tax-exempt organizations are subject to public inspection, but certain information is protected from disclosure, including donor names and addresses. The court said this provision allowed the foundation to refuse the release of the requested information, and it prohibited the IRS from releasing it as well. Since the foundation was a public charity, and the firm offered no substantial evidence to suggest it was anything otherwise, the court said §6104 provided a clear proscription against releasing such information. *Stanbury Law Firm, P.A. v. IRS*, Civ. 98-2598 (U.S. Dist Ct., Dist. Minn, 1999).

 **Responding to cries of charity abuse and scandal, Congress first enacted §6104 of the tax code in 1987.**

Although the provision is intended to allow public inspection of annual information returns, the law specifically protects the disclosure of donor information. In 1996, Congress further expanded public inspection by requiring tax-exempt organizations to furnish copies of their Form 990's upon request. That law finally became effective earlier this year, but many organizations are just now beginning to comply. Nonprofit Alert® Memo 9904-1, *Nonprofit Disclosure Requirements*, discusses the full impact of the law and what it means for your organization. See back page to order your copy.

conversion, however, Blue Cross/Blue Shield agreed to create a nonprofit 501(c)(3) foundation dedicated to helping resolve health issues. In return for an endowment from Blue Cross/Blue Shield, the foundation agreed to indemnify the company, then sought a ruling from the IRS confirming that any such indemnification would not result in private inurement or self dealing. The IRS responded favorably, noting that the agreement was neither a loan nor a transfer to a disqualified person, and therefore did not create any private benefit that would endanger the foundation's exempt status. IRS LTR 199926048.

Study Highlights Media Strategies for Nonprofits

A study by the Aspen Institute suggests nonprofits wishing to garner more media coverage should show editors how their organizations provide unique services to the community and engage volunteers in innovative work. Editors looking for "hot stories" find these angles especially appealing. Also of interest are stories that show how the government's provision of services is changing, thanks to nonprofits and the work they accomplish in local communities.

➡ **Copies of the study are free from the Nonprofit Sector Research Fund of the Aspen Institute at (202) 736-5838 or via email requests to nsrf@aspeninst.org. Visit the Institute's web site for more information at <http://www.aspeninstitute.org>.**

Tax Treaty: Trans-Border Without Transgressions

Article XXI of the U.S.-Canada Tax Treaty allows trans-border deductions and reciprocal recognition of exempt organizations under certain circumstances. For instance, U.S. nonprofits must be exempt under §501(c)(3) of the U.S. tax code to be recognized as exempt in Canada. U.S. residents may donate to Canadian charities but can only claim charitable deductions up to a percentage of their Canadian-sourced income. The treaty also requires Canadian charities that receive \$25,000 or more from U.S. sources to file an annual Form 990 tax return with the IRS. IRS Notice 99-47.

➡ **If your organization operates internationally or contemplates doing so, consult legal counsel for help in understanding his and other tax treaties that could affect your operations.**

For an introductory summary of the issues to consider when going global, order Nonprofit Alert® Memo 9812-1, *Operating Nonprofits Internationally*. See ordering information in the box at right, or call Gammon & Grange for help.

State Rules & Regs

California: First to Okay Electronic Signatures

Gov. Gray Davis signed a bill last month that makes electronic signatures legally valid in the state. When the law goes into effect January 1, 2000, electronic signatures will be as binding as handwritten signatures on legal documents. The law prohibits certain documents like wills and real estate contracts from being signed electronically. But state and local laws can **be signed electronically. In fact, Gov. Davis actually signed** law with his electronic signature. CA S.B. 820.

➡ **California is the first state to accept electronic signatures as legally binding. This marks a milestone in the evolution of e-commerce and Internet connectivity.**

Virginia Makes Local Charities' Property Exempt

A new law authorizes local governments to grant property tax exemptions to religious, charitable, historical, and other tax-exempt organizations if the locality makes certain findings about the organizations, including whether executive pay is reasonable. Exemptions expire after four years unless renewed by the locality. Currently, the General Assembly must approve these tax exemptions. The law is effective January 1, 2000. VA H.B. 1679.

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