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Nonprofit *Alert*®

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

Grand Jury, Sen. Grassley Investigate United Way

The nation's fourth largest United Way chapter, United Way of the National Capital Area (Washington, D.C.), is under investigation by a federal grand jury and Sen. Charles Grassley (R-IO) for financial mismanagement.

Financial Irregularities

Last summer, United Way employees alleged that executive staffers used the charity's funds for personal travel and other personal expenses. Executives denied the allegations, but an independent audit uncovered financial irregularities, including a premature pension payment of $200,000 to the organization's former executive director that he received two years before his actual retirement. The audit also revealed booked pledges of $2.5 million that were never received.

United Way officials admit the charity retained more money from donations than was necessary to cover uncollected pledges. This prompted a federal grand jury to subpoena United Way board membership lists, financial records, and other data dating back to 1997.

Fundraising Delayed

Now, United Way has delayed its annual fundraising drive, scheduled to begin on Sept. 1, in order to contact supporters while a United Way of America ethics committee reviews the chapter's policies and procedures.

Many of the chapter's chief supporters are withdrawing their support, including the American Bankers Association and the Washington Redskins football team, which cancelled its annual "Hometown Huddle" work project. ExxonMobil also announced it will no longer use United Way (D.C.) as its sole charitable fundraiser.

On other fronts, Brian Gallasher, the President of United Way of America, has called for the resignation of United Way (D.C.) President, Norman Taylor. Sen. Grassley, the ranking Republican on the

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Webcaster Relief Revisited

Last month, Nonprofit *Alert*® reported that the U.S. Copyright Office planned to reject a newly proposed webcasting rate of 14 cents per listener, per song, and instead mandate a lower rate of 7 cents. Now the story gets even better.

One day before Congress adjourned for its August recess, several lawmakers introduced a bill that would allow small Internet broadcasters to defer royalty payments until a new round of negotiations on webcasting fees is held next year. The bill defines "small Internet broadcasters" as those with less than $6 million in annual revenues.

The bill would also allow these small webcasters to participate in royalty negotiations without paying arbitrators' fees, and would exempt them from royalty payments on "ephemeral" buffer copies of songs that are stored on Internet servers but never heard by the public.

If the bill does not pass when Congress resumes in September, webcasters and others using statutory licenses for webcasting will have to pay royalties for all their activities taking places under these licenses during the period from Oct. 28, 1998 through Sept. 1, 2002.

Those payments will be due not later than Oct. 20, 2002. Payment for activities after Sept. 1 are due on or before Nov. 14, 2002. Webcasters that do not qualify for the statutory license must negotiate webcasting fees individually with the recording industry.

Opponents of the bill argue it will prevent songwriters and musicians from receiving fair pay for their work. Supporters praise the bill for reprieving from bankruptcy thousands of small Internet radio companies.

For more information on webcasting royalty compliance, contact Gammon & Grange attorney, Kenneth Liu, (703) 761-5000. A detailed description of the Copyright Office's report is on-line at www.copyright.gov/carp/webcasting_rates_final.html.

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Liability & Risk Management

Parsonage Exclusion Update: Professor Makes Motion to Intervene on Constitutionality

As Nonprofit *Alert*® reported previously, the constitutionality of the parsonage housing allowance exclusion recently came under fire in the 9th Circuit Court of Appeals case, *Warren v. Commissioner*. (NPA, May & June '02). The primary issue in this case (i.e. whether the housing allowance exclusion must be limited to the fair rental value of the home) was resolved in May when Congress enacted federal legislation amending Section 107 of the tax code. The parties in the case later filed a joint stipulation of dismissal, but the Ninth Circuit is now considering a motion to intervene filed by Professor Erwin Chemerinsky. The professor previously filed a brief at the Court's request regarding the constitutionality of the parsonage exclusion. In that brief, he argued that the exclusion is unconstitutional. In this new motion, Professor Chemerinsky argues that the Court has authority, upon his intervention motion as a taxpayer, to rule on the constitutionality of the statute even though the parties to the case have requested dismissal. The Court has not yet ruled on the professor's motion at press time, but stay tuned for updates this fall. *Warren v. Commissioner*, 9th Cir. No. 00-71217.

Does the court have authority to rule on constitutionality of tax code provision when parties request dismissal?

For additional information on the ministerial housing allowance, refer to Nonprofit Alert® Memo, *Ministerial Housing Allowances: Qualifying and Documenting*. See back page to order.

Nonprofit Disclosure Stripped From "Enron Bill"

Most Enron-related news has not been good lately, but here's a positive note for nonprofits: all of the nonprofit disclosure provisions included in the corporate reform legislation were deleted from the final measure before it became law last month. Pres. Bush signed the so-called "Enron Bill" (H.R. 3763 and S. 2673), reported in last month's Nonprofit *Alert*®, amid much fanfare because it brought sweeping changes to corporate financial reporting and disclosure. This bill originally required publicly-held corporations to disclose any of their directors, executives, or "immediate family members" of such directors or executives who served as an officer or director of a nonprofit organization. Disclosure was also required if a corporation or executive made any gift over $10,000 to a nonprofit in the past five years. Charity advocates opposed the nonprofit disclosure requirement because they claimed it would place an onerous burden on corporations that would likely result in fewer corporate charitable contributions and activities. A House-Senate Conference Committee agreed and pulled the language during final debates on the measure.

Employees & Volunteers

Religious Hospital May Forbid Religious Speech

The California Supreme Court has ruled that a Catholic hospital has the right to control religious speech in its workplace and terminate an employee who disobeyed the hospital's instruction not to speak the word "God" at the hospital. The hospital was organized under the auspices of the Roman Catholic Church for the purpose of furthering the church's teachings. However, the hospital did not have a chaplaincy or chapel, prayer groups or Bible studies, religious symbols, displays, or any religious services on premises. In 1992, a file clerk in the hospital experienced a religious conversion and began to share his faith with co-workers in the hospital. Upon receiving two complaints about the clerk's "preaching," the hospital's human resources manager counseled him not to use the word "God" during working hours at the hospital. Eventually, the hospital terminated the clerk's employment, and he sued for discrimination. The trial court held that the hospital unlawfully discriminated against the clerk based on his religious beliefs, in violation of the state's public policy and Fair Employment and Housing Act (FEHA). On appeal, the California Supreme Court reversed, holding that the hospital was a religious organization exempt from FEHA, despite the hospital's prohibition of certain religious speech, because "de-emphasizing its distinctively Catholic affiliation, appears to be part of [the hospital's] religiously inspired mission." The Court held that the termination was protected under the constitutional principle that religious employers have discretion to choose employees who will not interfere with their religious mission or message. The Court suggested that restricting the hospital's ability to control religious speech would excessively entangle the court in deciding what constitutes "religious speech," in violation of the First Amendment. *Silo v. CHW Medical Foundation*, 27 Cal.4th 1097 (Ca. 2002).

Catholic hospital qualifies as religious organization despite its lack of overt religious traits.

This decision is limited to the particular facts involved. Under federal and state laws, religious organizations are generally prohibited from discriminating on the basis of sex, race, national or ethnic origin. Read more in Nonprofit Alert® Memo, *Hiring & Firing: Rights of Religious Employers*.

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EEOC Now Tracks 9/11 Backlash Discrimination

"Narinder, a South Asian man who wears a Sikh turban, applies for a position as a cashier at XYZ Discount Goods. XYZ fears Narinder's religious attire will make customers uncomfortable. What should XYZ do?" The EEOC poses this question—along with several other employment discrimination-related questions and answers—in its recently-published fact sheet, *Questions and Answers About Employer Responsibilities Concerning the Employment of Muslims, Arabs, South Asians, and Sikhs*. This fact sheet is one of the EEOC's responses to the significant increase in the number of workplace discrimination complaints based on religion and/or national origin that have arisen since 9/11. The fact sheet includes information about hiring, harassment, religious accommodation, temporary assignments, and background investigations. The EEOC has also implemented a new "Code Process Type Z" database, retroactive to 9/11, to track how many workplace complaints involve claims of backlash discrimination related to the events of 9/11. The EEOC reports that during the eight-month period following 9/11, it received 497 discrimination charges on the basis of the Muslim religion compared to 193 such charges the prior year. [FYI: the EEOC's answer to the above question is, "XYZ should not deny Narinder the job due to notions of customer preferences about religious attire. That would be unlawful. It would be the same as refusing to hire Narinder because he is a Sikh."]

This fact sheet is available by contacting the EEOC's Publications Distribution Center at (800) 669-3362. or on-line at www.eeoc.gov/facts/backlash-employer. The EEOC web site also offers a "September 11 Information" section with additional materials and resources.

Tax-Exempt Issues

NPA Highlight of the Month

Post 9/11 Issues Less Problematic Than Predicted

At the one-year anniversary of September 11, 2001, the charitable community in the United States appears to have suffered minimal lingering effects from the terrorist attacks. Two issues that were predicted to have devastating effects on charities were the potential decline in charitable giving and the increased governmental oversight of charities. Neither has had the traumatic effects once expected.

Decline in Charitable Giving: Shortly following 9/11, many charities reported decreased donations, as many Americans diverted their charitable dollars to assist 9/11 victims and rescue organizations. However, *Giving USA* reported in its annual survey, released this summer, that charitable giving actually increased a half percent (0.5%) in 2001. Although this increase was significantly lower than the 6% increase in 2000, the increase in 2001 is a more typical rate of growth, according to Leo P. Arnoult, chair of the AAFRC Trust for Philanthropy. "Research shows that giving is closely tied to the economy. Not surprisingly, giving in 2001 fits the pattern that we have seen during previous recessions," Arnoult commented. The *Giving USA* survey also reported that gifts made to relief and recovery after 9/11 totaled slightly less than 1% of the total estimated $212 billion in charitable giving for 2001.

The Evangelical Council for Financial Accountability (ECFA) is surveying its member organizations on whether they have experienced a growth in total giving in their most recently completed fiscal year. While the survey is not yet complete, just over 50% (almost 500) of ECFA members have responded as follows: 63% yes, 35% no, 2% don't know. In an interview with Nonprofit *Alert*®, Dan Busby, Vice President of ECFA Member and Donor Services, attributes this increase to the giving standards of ECFA's members. "While the economy and Sept. 11th did a double-whammy on the nonprofit world, the resiliency of Christians to step up and replace dollars was laudable," Busby says.

Government Oversight and Regulation: The Victims of Terrorism Tax Relief Act, enacted in January 2002, expanded the Treasury Department's access to tax return information for purposes of investigating terrorist incidents, threats, activities, and charities that support terrorist organizations. The Deputy Secretary of the Treasury, Kenneth W. Dam, noted in a recent hearing before the U.S. Senate Subcommittee on International Trade and Finance that Treasury has designated several Islamic charities overseas, and at least one domestic charity (the Holy Land Foundation for Relief and Development) as terrorist supporters. Treasury has blocked the assets of these organizations. Dam said another aspect of Treasury's "domestic strategy" is to limit potential abuse of charities through oversight of charitable activities and "ensur[ing] that charities are transparent to the maximum extent possible," although he did not provide specific details on this oversight process. He emphasized the role of private watchdog organizations, including ECFA, Independent Sector, the Council on Foundations, and GuideStar, in promoting greater oversight and transparency.

The IRS Exempt Organizations Division is conducting 150 market segment examinations of organizations in several exempt categories, including community trusts, social service groups, and non-church religious organizations . Charities involved in providing 9/11 relief are facing increased IRS scrutiny. Marvin Friedlander of the Exempt Organizations Division told Nonprofit *Alert*® that the Division plans to conduct a statistical review of over 600 charities that it has identified as having 9/11-related programs, and to conduct audits of the more "troublesome" charities. Given the increased possibility of an IRS audit, particularly for charities involved in 9/11-related programs, your charity's board should be proactive and arrange for (1) an independent audit, and (2) a legal audit. Please contact us if you would like more information on Gammon & Grange's Nonprofit Legal Audit™ services.

Charities-In-Charge: Tax Deductible Shopping

Looking for a good reason to go shopping? Here's one: credit card rebates can be tax deductible. The IRS has ruled that contributions to charities pursuant to a credit card program that offers cardholders the option to either keep cash-back rebates or donate such rebates to charity are tax deductible. A taxpayer requested IRS confirmation that a donation of her rebate would be tax deductible and that the rebate would not be deemed taxable income when participating in this program. The IRS ruled in favor of the taxpayer, finding that the presence of the following mandatory elements of a completed charitable gift made it tax deductible: (1) voluntary enrollment and payment; (2) donative intent; and (3) compliance with substantiation requirements under Section 170 of the Internal Revenue Code. In addition, the IRS ruled that a rebate is a reduction in the purchase price of an item and is not an accession to wealth. Thus, the rebate amount is not included in the cardholder's taxable income. PLR 200228001.

Charitable rebate programs are increasing in popularity among credit card companies. Contact credit card companies directly to inquire about how your charity or its donors may participate.

Split-Dollar Deductions Denied as IRS Cleans Up

The Tax Court has recently held in two similar cases that donations connected with charitable split-dollar insurance programs offered by the National Heritage Foundation (NHF) are not eligible for a charitable contribution deduction because the donors failed to obtain adequate written substantiation of their donations. Under charitable split-dollar insurance programs, touted by some organizations in the mid- to late 1990's, charities would pay premiums for life insurance policies on the lives of donors, with death benefits split between the charities and beneficiaries named by the donors. A donor would contribute sums to an organization that were essentially equal to the amount of the life insurance premiums, but this scheme was eliminated by federal legislation in 1999. However, the IRS is still cleaning up prior arrangements by denying donors' tax deductions for contributions made to cover premiums. The clean up tactic that the IRS used in the NHF cases is the written acknowledgment requirement of Section 170(f)(8) of the tax code. The Tax Court found that the donors' receipts falsely stated that no goods or services were provided in exchange for the donors' contributions, because the donors expected the donee organizations would use the contributions to buy insurance for the donors' benefit. *Addis v. Commissioner*, 118 T.C. No. 32 (2002); *Wiener v. Commissioner*, T.C. Memo, 2002-153 (2002).

Although charitable split dollar insurance is now of historical interest only, these cases demonstrate that the Tax Court is willing to strictly apply the donee acknowledgment requirement. For further information, see Nonprofit Alert® Memo, *Charitable Gifts: Receiving and Receipting*.

United Way Under Scrutiny

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Senate Finance Committee that oversees exempt organizations, sent a letter to both United Way of America and United Way (D.C.) requesting information about the chapter's funding sources, performance standards, financial accountability, and disciplinary procedures. Grassley gave the groups until September 23 to respond.

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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