



Nonprofit *Alert*®

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

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In Surprise Reversal . . .

IRS Gives Thumbs Up Approval to Nonprofit's Joint Venture

The IRS has given the go-ahead for a nonprofit health care organization to proceed with an ancillary joint venture that, just last year, the IRS had disapproved.

The reversal effectively ends a dispute that had been tied up in Tax Court since October when the IRS denied exempt status to

the John Gabriel Ryan Association (JGR), a nonprofit organized to promote and provide health care services. The IRS reversed its decision before the Tax Court could rule on the matter.

The IRS initially claimed JGR's activities benefitted private interests and did not exclusively further charitable purposes. JGR petitioned the Tax Court for review of the IRS's decision, arguing that its sole activity consisted of "participation in five ancillary healthcare provider and medical office building joint ventures." The ventures were all structured on behalf of a nonprofit, tax-exempt, religiously affiliated health care

system that provided services in Alaska, California, Oregon, and Washington. Three of the ventures involved partnerships between

JGR and other exempt community organizations in specific regions. Two of the ventures involved similar partnerships, but with for-profit entities instead. In those ventures, JGR served as a co-general

partner with the for-profit entities.

The IRS's reversal retroactively restores JGR's tax exempt status to December 30, 1998, the date it first filed its Form 1023 application for tax exemption. This development follows last summer's litigation in the widely watched *St. David's Healthcare System* case, which involved a similar fact patten.

In *St. David's*, a federal court in Texas ruled that a nonprofit hospital's joint venture with a for-profit health care company does not interfere with the nonprofit's exclusive charitable operations. That decision is now on appeal to the 5th Circuit, however.

(continued on p. 4)

Joint ventures are possible if the nonprofit exercises equal control without compromising its mission...

NPA becomes eNPA next month! See p. 4 for details.

Liability & Risk Management

No Immunity for Fender-Bender Volunteer

A state law that protects volunteers from liability does not provide *full* immunity, a Florida appeals court has ruled. The ruling remands a case involving a volunteer citizen patrol for the Palm Beach Sheriff Department who rear-ended another automobile stopped at a red light. The volunteer was allegedly talking on his cell phone at the time of the incident and reportedly told the driver he simply didn't see her stopped car.

She brought suit, claiming the volunteer's negligence led to the crash. Citing Florida's Volunteer Protection Act, the trial court ruled for the volunteer. The court explained that the legislature intended to provide immunity for volunteers for negligent acts committed in their capacity as volunteers.

But the appeals court reversed the lower court's decision and ruled the law does not provide full immunity to volunteers. Instead, the court held that the intent of the law is "to shift liability from the volunteer to the nonprofit organization only where the volunteer

is exercising reasonable care...." The state act protects volunteers against personal liability when they act as a "reasonably prudent person[s]... under the same or similar circumstances" and "in good faith" within the scope of their volunteer duties. Because issues existed over whether the volunteer was using reasonable care at the time of the accident, the court remanded the case. *Campbell v. Kessler*, FL Ct.App., 4th Dist., No. 4D01-5034 (5/7/03).

 *This ruling stands as a warning to nonprofits relying on volunteer protection statutes to relieve their responsibility for volunteer risks: don't do it! Such laws – even the federal Volunteer Protection Act – provide a certain level of comfort for volunteers, but they don't insulate the organizations charged with supervising those volunteers from all liability. Careful administration and supervision of your volunteer programs, along with adequate insurance coverage, are important risk management measures for your nonprofit.*

Go to Jail; Do Not Pass Go, Court Tells Donor

A donor who fraudulently used a donor-advised fund (DAF) for his own personal gain has been sentenced to five months in prison, plus five months of home detention and two years of parole. The donor and his wife established the DAF in 1995 through the National Heritage Foundation (NHF). For the four years following, the donor took charitable tax deductions for contributions that he requested NHF to make from the DAF.

Instead of directing the contributions to charitable purposes, however, he directed NHF to make contributions from the DAF to his children's school to cover their tuition. The scam escaped notice because he made contributions via checks written to NHF.

NHF then made payments from the DAF, in the amount of the donor's contributions, to the school named by the donor. Pursuant to instructions from the donor, the school applied the payments toward his children's tuition.

Donor advised funds allow donors to recommend—but not require—the charity to make distributions from the funds.

Opera Group Hits Flat Note: Lawsuit Alleges Misappropriation

A Texas foundation, responsible for overseeing designated contributions from the estate of an oil heiress, has sued one of the estate's beneficiaries, the New York Metropolitan Opera. The foundation alleges the Met misappropriated the heiress's designated gift.

According to the donor's instructions at her time of death, the money was to be used only for traditional opera productions. But the donor's representatives claim the money funded a television production of one non-traditional performance in 2001, plus the costs of other unrelated productions since that time. The foundation now seeks recovery of \$5 million.

Met representatives claim they have artistic license to use the donation for traditional opera production as they interpret the term.

 *Just as opera lovers differ in their interpretations of "traditional," so, too, may donors who designate their gifts for specific purposes. To avoid this problem, ensure that any written instructions from your donors are clear and consistent with your organization's activities before accepting the gift.*

Be candid with donors about your organization's charitable gift policies, including the organization's right to redirect the gift to other uses if necessary to comply with the organization's purposes or applicable law. Ultimately, the organization must maintain full discretion and control of the gift for the donor to qualify for a charitable tax deduction.

Refer to Nonprofit Alert Memo, Donor Designated Gifts: Pitfalls & Provisos, for additional information. See back page to order.

Tax Exempt Issues

Health Club Gives YMCA a Legal Workout on Business Competition

The Fitness Factor, a commercial health club, may seek an injunction against a local YMCA to prevent the YMCA's expansion into a new facility, a Pennsylvania appeals court has ruled. The state's charity laws contain an anti-competition provision that bars nonprofits from operating, funding, or subsidizing any commercial activity not within their charitable exempt purposes.

The principle behind the law is to prevent charities from competing with commercial entities, especially small businesses. The Fitness Factor sued to prevent the YMCA from building a new 35,000 square foot fitness facility that the Fitness Factor claimed would operate for commercial purposes.

An arbitrator ruled for the YMCA, and a trial court later upheld that ruling,

finding that construction and operation of the fitness facility was well within the YMCA's charitable purpose of "promoting physical welfare." The state appeals court overturned the ruling, however, saying that all sports activity doesn't necessarily fit within the YMCA's exemption.

The court remanded the case for further fact finding to determine whether the new facility would further the YMCA's exempt purposes under a totality of the circumstances test. *Selfspot v. Butler County Family YMCA*, No. 2112 C.D.2000 (2/25/03).

 *Commercial activities by nonprofit organizations are often criticized as unfair competition with for-profit businesses. Federal tax laws attempt to level the playing field by taxing income produced by many of these unrelated commercial activities.*

Federal tax laws attempt to level the playing field by taxing nonprofit income produced by unrelated commercial activities. This is known as UBIT.

Highlight of the Month

Recession Prompts Employee Fraud; Cost to Nonprofits: \$10 Billion

Employee fraud costs U.S. charities at least \$10-billion annually, according to one estimate, and that number appears to be escalating with the current recession, some observers say. Over the last several years, the economic downturn created personal financial troubles that have apparently motivated more employees to steal money, forge checks, or engage in other fraudulent schemes.

Economic troubles have also compelled nonprofits to cut back on staffing, leaving more duties for fewer employees, but with less oversight and poor internal controls. The result: shocking but eye-opening examples of employee theft at charities across the country.

For example, the finance director of United Arts of Central Florida was arrested earlier this year for allegedly stealing over \$172,000 after working at the charity for only seven months. In June, the director of the Thornton Kidney Research Foundation of Los Angeles was sentenced to eight years in prison and \$644,000 in restitution after being convicted of wire and mail fraud. Also this summer, three employees of the Indianhead Community Action Agency in Wisconsin were charged with check forgeries amounting to over \$1 million. How can a charity prevent such fraud? Experts offer these tips:

- Conduct employee background checks before hiring. Weeding out bad apples *before* they land in your basket is the most cost effective and risk-free solution.
- If you accept donations online or by credit card, review accounting controls to make sure proper checks and balances are in place so access to these potential sources of abuse isn't concentrated in a few employees.
- Consider upgrading your accounting system to better track all donations, grants, work hours, etc., and invite a professional accounting or legal firm to conduct a risk review.

Nonprofit Alert Memo, *Accounting & Fiduciary Guidelines*, offers helpful analysis. See back page to order. For consultation about a comprehensive Legal Audit, contact Stephen H. King at (703) 761-5000.

Nonprofit Alert®

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No More Faxes: FCC Rule Change Affects Nonprofit Marketing

New federal rules may soon prohibit organizations from sending unsolicited faxes without first obtaining the signed, written consent of the recipient. Any organization, both nonprofit and commercial, that communicates via fax—even to its own members, donors, or clients—is affected.

Old rules included a broad exception for faxes sent to people who had an “existing business relationship” with the sender. A little-known provision in recent legislation that instituted the federal “do-not-call” list eliminated that exception, which had protected nonprofits for over a decade.

The new rule, issued by the Federal Communications Commission, originally went into effect Aug. 25. But after numerous associations and charity groups filed petitions for review, the FCC extended the effective date to Jan. 1, 2005, to permit more time for affected nonprofits to comply. Read more about this issue and what it could mean for your nonprofit at <http://www.asaenet.org>.

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Joint Venture (cont. from page 1)

This latest decision by the IRS provides instructive guidance for any nonprofit planning to partner with for-profits.

In essence, it suggests that a nonprofit/for-profit joint venture is permissible as long as the nonprofit exercises at least equal control (i.e. 50% or greater) over the venture and appropriate protections are instituted to ensure the nonprofit’s charitable purposes and operations are not compromised.

However, this area of nonprofit law is rapidly evolving. Before your organization enters any partnership or joint venture arrangement with a for-profit entity, seek legal counsel.

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