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

FINAL VERSION OF NEW IRS FORM 990 NOW AVAILABLE

The IRS released its final version of the redesigned Form 990 to be used for filing charitable and other tax-exempt organization returns for tax years beginning in 2008. The revisions reflect the ever increasing sophistication of charitable activities and the need for greater accountability.

The final form is still composed of a core form and a series of schedules. As compared to the current Form 990, the new form provides greater opportunities for an organization to describe its charitable activities, while requiring more information about management and governance policies.

Recognizing the increased level of complexity, the IRS is giving smaller organizations the option of filing the shorter Form 990-EZ during a transition period. For returns covering tax years beginning in 2008, only organizations with gross receipts

over \$1 million or total assets in excess of \$2.5 million are required to file the full revised Form 990. Those organizations under the threshold may file Form 990-EZ. For returns covering tax years beginning in 2010, those thresholds fall to \$500,000 and \$1.25 million. After 2010, the key amounts required for filing the full Form 990 will be set at \$200,000 for gross receipts and \$500,000 for total assets.

As the first significant revision to the Form 990 for more than 25 years, the IRS hopes that its new Form 990 will make it easier for the public to understand the financial operations of charitable organizations while also more effectively ferreting out organizations that violate the tax laws. The final version of the new Form 990 is available on the Exempt Organizations portion of the IRS Web site at:

www.irs.gov/eo.



Pastor's Assistance in Drafting a Will Challenged but not Deemed Undue Influence

An elderly woman requested that a pastor the woman knew assist with the preparation of her will. While the woman visited the pastor and his wife on various occasions and often attended the pastor's church, she did not join the church, and evidence was introduced that the woman did not consider this pastor to be her pastor. After several requests, the pastor agreed to help the woman and purchased software to assist in the preparation of the will. After the woman passed away, some of her heirs challenged the will as invalid. The will listed the pastor's church as a beneficiary and appointed the pastor as executor of the woman's estate.

A Tennessee trial court invalidated the will on a motion for summary judgment due to **1)** undue influence exerted by the pastor over the woman, and **2)** the unauthorized practice of law by the pastor. However, the pastor appealed this decision and the appellate court reversed, explaining that the doctrine of undue influence applies only where there is a confidential relationship where one party is able to dominate the other. Here, there was not sufficient evidence to conclude as a matter of law that a confidential relationship existed and that undue influence had been exercised. Further, the appellate court held that even if the pastor's actions constituted the unauthorized practice of law, this did not invalidate the properly executed will, which was witnessed by individuals who did not know the pastor. Thus, the case was remanded to the trial court.

A New Year, a New NonProfitAlert®

We hope you enjoy the new layout and design of the NonprofitAlert®. We will continue to bring you the same great content in a new, fresh format. Let us know what you think!

Do you like the current layout of the Nonprofit Alert?

Yes No

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➡ Although the pastor in this case survived a motion for summary judgment, the case highlights the potential risks of involvement by an organization or its leadership in the drafting of wills or other legal documents, especially if it results in a financial or other benefit to the organization. A nonprofit should always recommend that constituents, when seeking advice regarding potential bequests or planned gifts, seek their own financial and legal counsel.

WITHOUT CHURCH POLICY TO THE CONTRARY, COURT FINDS PASTOR HAS EXPECTATION OF PRIVACY IN CHURCH-OWNED COMPUTER

This case highlights the importance that organizations implement and communicate a policy that employees have no expectation of privacy of information stored on organization-owned computers. A Florida appeals court recently ruled that child pornography taken by police without a warrant from the church-owned computer of a Methodist pastor could not be used as evidence in criminal charges brought against the pastor. The pastor's office and church-owned computer were searched by police with permission of the district superintendent after the church administrator, running an anti-virus program on the computer triggered by a call from the church's Internet provider, noticed that several questionable website addresses were stored.



the pastor kept two of the three keys to the special lock (the third kept in a locked credenza by the church administrator). Also key to the Court's decision were the facts that the pastor's computer was not networked with any other church computer, and that the church had no official policy regarding use of the computer or access to it. The Court concluded that these facts added up to an expectation of privacy for the pastor that was well beyond what most employees enjoy.

The Florida Court ruled that evidence gained from the police search of the computer could not be used in the trial because the pastor had an expectation of privacy in the church-provided office and computer. In reaching this conclusion, the Court noted that the office and computer were reserved for the pastor's exclusive use, the office had a special lock that could not be opened with the church's master key, and

➔ To guard against a similar result, churches and other nonprofit organizations should adopt and implement a policy that employees are to have no expectation of privacy in their use of and information stored on organization-owned computers and computer networks (including use of email and the Internet). This policy should be clearly communicated to employees in writing on a regular basis. For assistance in developing such a policy, or other policies related to information technology, contact Gammon & Grange, P.C.'s **Scott Ward**.

PANEL ON NONPROFIT SECTOR ISSUES PRINCIPLES OF GOOD GOVERNANCE

Following up on its work over the past 3 years in proposing charitable reforms at the request of the Senate Finance Committee, the Panel on the Nonprofit Sector recently issued 33 principles of exemplary governance directed toward assisting charities improve accountability and transparency. The report, Principles of Good Governance and Ethical Practice: A Guide for Charities and Foundations, covers legal compliance and public disclosure, board oversight and governance responsibilities, financial oversight, and fundraising responsibilities.

Placing the onus for charitable responsibility squarely on the shoulders of board members and chief executive officers, the report reinforces that enforcement has to come from within. Although the IRS will soon require charities to describe more fully their management and governance policies and practices on the new IRS Form 990, the task is too large for government enforcement alone. The report asserts that directors and officers have the primary responsibility of ensuring that their organizations honor their "legal and ethical obligations to donors, consumers, and the public."

Charities wishing to review the report can access a free reference edition at

<http://www.nonprofitpanel.org>.

Executive Compensation on the Rise at Larger Nonprofits



A recent GuideStar® study reports a 7.3 percent median increase in compensation for the chief executives of nonprofits with annual budgets exceeding \$50 million. This compares to a 4.2 percent median increase

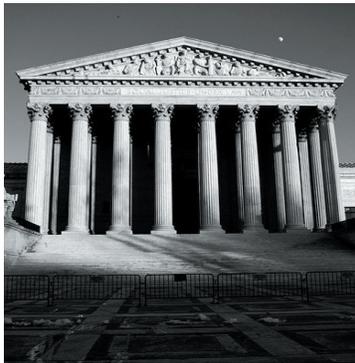
for chief executives in organizations with budgets between \$1 and \$2.5 million, and only a 2.1 percent median increase at charities with budgets under \$250,000. Thus, the gulf between rich and poor nonprofit executives

is increasing. The median CEO compensation at the \$50 million plus organizations is now at \$336,000 compared to only \$38,800 at the nonprofits with budgets under \$250,000.

COURT RULES AGAINST NONPROFIT'S CONTENTION THAT EXECUTIVE SECRETARY IS EXEMPT UNDER FLSA.

A federal district court in Maryland recently considered the “white collar” administrative exemption under the Fair Labor Standards Act (“FLSA”) after the former executive secretary of a nonprofit organization sued for overtime compensation. Under the FLSA, employees generally must be paid time and half for hours exceeding 40 that are worked during a week. However, salaried employees meeting one of the white collar exemptions are exempt from the overtime pay requirement. If an employer’s classification is challenged, the employer has the burden of proving by clear and convincing evidence that an exemption is applicable.

The administrative exemption under the FLSA applies to employees compensated on a salary basis at a rate of not less than \$455 per week, whose primary duty is



the performance of office or non-manual work directly related to the management or general business operations of the employer, and whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

In the Maryland case, although the executive secretary’s job description indicated that the position was considered FLSA-exempt, and gave the executive secretary authority to delegate assignments and supervise the receptionist, the Court noted that that the job description was not as important a factor as the actual duties of the executive secretary. In citing evidence supporting the executive secretary’s position that her duties were primarily clerical in nature (such as ordering supplies, taking minutes at

company meetings, and completing forms), the Court concluded that a reasonable jury could find that the employer had not met its burden of showing that the primary duties of the executive secretary related to the management or general business operations of the employer. The Court also noted that a reasonable jury could conclude that the primary duties of the executive secretary did not involve exercise of discretion as to matters of significance.

⇒ **Misclassification of workers may end up being an expensive mistake. A determination of whether or not a position is FLSA exempt should be carefully made in consultation with legal counsel. For more information on the FLSA white collar exemptions, order Gammon & Grange, P.C.’s [Nonprofit Alert memo FLSA: What It Means for Nonprofit Employers.](#)**

IRS BRIEFS

IRS 2008 Workplan. The IRS recently released its fiscal 2008 workplan for the exempt organization’s division. A focal point this year will be an investigation into four-year colleges and universities, particularly examining compensation and endowment spending practices. The IRS will continue several of its emphases from 2007 including (1) executive compensation (focusing on loans to organizational executives), and (2) donor advised funds. Given that 2008 is an election year, the IRS will again be raising the flag regarding the prohibition on political intervention by 501(c)(3) organizations. It recently released its normal election year warning against engaging in activities on behalf of or in opposition to a political candidate.

IRS Workshops. The IRS will continue to offer one day workshops for administrators of small and mid-size tax exempt organizations. Workshops address the benefits and responsibilities of exempt organizations, and actions that jeopardize exempt status. The next workshops will be held in Arlington, VA (April 1, 2, and 3), Austin, Texas (May 6, 7, and 8), and Columbus, Ohio (May 20, 21, and 22). Pre-registration is required either on the IRS website (www.irs.gov) or by calling 800-521-3980. The workshop fee is \$45.

KEEPING WATCH: VERIFY THAT PAYROLL TAXES ARE CORRECTLY FILED

When the IRS notified a company that its payroll taxes were short for two years with an outstanding tax obligation in the \$1 million dollar range, the employer did some investigating only to find that an employee of its payroll service had embezzled the money. This individual, who was eventually convicted of criminal fraud and tax evasion, had underpaid the payroll taxes and pocketed the difference.

When the IRS assessed the company for the delinquency, the company sued in federal court claiming that it could not be held responsible for the criminal activity of the payroll service's employee. The federal appeals court disagreed, reaffirming the well established principle that "a taxpayer's reliance on a third party to fulfill its tax obligations does not relieve the taxpayer of responsibility for those obligations." Even the deliberate theft of funds directed to be paid to the IRS does not relieve a taxpayer of its tax obligations.

⇒ This case points to the importance of monitoring that a third party payroll service is filing the organization's payroll correctly. The EFTPS (Electronic Federal Tax Payment System) allows an employer to regularly monitor payment history online. Also, employers should verify that their payroll service provider has a fiduciary bond in place in case the employer must seek indemnification for tax liabilities.

UPDATE FROM CAPITOL HILL: CONGRESS INVESTIGATING CHARITIES ON MULTIPLE FRONTS

Congress is pursuing a number of different investigations into real or perceived abuses by the charitable community, with some Hill insiders predicting that hearings will serve as a springboard to additional legislative reforms.

In November, Senator Grassley, the ranking Republican member of the Senate Finance Committee, began an inquiry into several high profile **media-based Christian ministries**, seeking information about the nature and amount of executive compensation and benefits, the composition and selection of the governing bodies, credit card and personal expenses, and specific details about transactions between the organizations and their leaders. Among those contacted were World Healing Center, Inc. and Benny Hinn Ministries, New Birth Missionary Baptist Church and Bishop Eddie Long Ministries, and Joyce Meyer Ministries. The original December 5 deadline for responding passed with several ministries providing or promising information, but one ministry refused to cooperate without a subpoena. Grassley has extended



the deadline indefinitely. The same month, Finance Committee tax counsel Dean Zerbe reported that the Committee is examining complex relationships between **large organizations and for-profit and nonprofit subsidiaries**, and **universities with large endowments** that charge high tuition rates and pay high compensation to school officials.

Grassley also is continuing his efforts at reforming **nonprofit hospitals**. Among the reforms proposed by his staff last summer: requiring hospitals to allocate a minimum percentage of their annual revenue to charity care, and increasing Schedule H reporting requirements on the Form 990.

Fundraising by charities is also undergoing intense scrutiny. In December, the Senate Banking, Housing and Urban Affairs Committee held a hearing on charities' spending on fundraising, and the fees charged by professional solicitation companies. During that hearing, Senator Menendez (D-NJ) specifically criticized companies that use charities to promote their

products but give the charities little or no money in return.

Meanwhile, in a separate hearing, the House Oversight and Government Reform Committee criticized **veterans charities** which only deliver to veterans an insubstantial portion of the funds they raise. Some watchdog groups and Hill insiders are predicting that fundraising may be a subject in the next round of federal reforms affecting charities.

We will provide you with updates as Congress pursues further inquiries and considers potential reforms.

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8280 Greensboro Drive, 7th Floor,
 McLean, VA 22102-3807
 (703) 761-5000 Fax: (703) 761-5023 • E-mail: npa@gg-law.com

Editor-in-Chief George R. Grange II
Editor Steve King
Publications Coordinator . . . Jo-Anne Kehmna
Layout/Design/Web Designer Thomas Jubb

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