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Nonprofit Alert®

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

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Supreme Court Upholds State Law Prohibiting Government Funding of Religious Study

States may exclude students pursuing theology degrees from state-sponsored scholarship programs, the Supreme Court has ruled in a 7-2 decision. The case centered around a scholarship program in Washington state, but the ruling may have implications beyond such state-funded programs. Opponents of President Bush's faith-based initiatives say they'll use the ruling to prevent the use of federal dollars for social service programs operated by religious groups, although nothing in the Court's opinion precluded the government from funding such programs.

Writing for the majority, Justice Rehnquist said the Court "cannot conclude that the denial of funding for vocational religious instruction alone is inherently constitutionally suspect." The decision upheld Washington's Promise Scholarship program, which provides aid indiscriminately to students who meet certain academic, income, and enrollment requirements. Students may use the scholarships to attend religious colleges and universities if those institutions are accredited. But the program specifically denies aid to students pursuing theology degrees because Washington state law prohibits spending public funds on religious education.

> "... there is room for play in the joints" between the Establishment Clause and the Free Exercise Clause, the Court said.

Background of the Case

Joshua Davey, a first year student at Northwest College, received a Promise Scholarship and enrolled as a double major in pastoral ministries and business administration. The pastoral ministries major was considered devotional or theological under the scholarship guidelines. When his scholarship money was denied on the grounds that such funding of theological education would violate state law, Davey brought suit, claiming a violation of the First Amendment's Free Exercise and Establishment Clauses.

A lower court rejected his claims, but the Ninth Circuit Court of Appeals reversed the ruling, finding the state's exclusion of theology from the scholarship program had to be narrowly tailored to achieve a compelling state interest under the doctrine of *Church of Lukumi Babalu Aye, Inc. v. Hialeah,* 508 U.S. 520. The Ninth Circuit held that if the state was to single out religion for unfavorable treatment, *(continued on page 2 ...)*

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Religious Study . . . . . *(continued from page 1)*

then *Lukumi* mandated that it be narrowly tailored. The Ninth Circuit thought Washington's scholarship program failed that test.

The Supreme Court disagreed with the Ninth Circuit's reasoning, however, ruling the *Lukumi* mandate does not require government to fund religious study. Even though Washington's state constitution defines the separation of church and state more narrowly than does the federal Constitution, the Court said the separation it attempts to protect is an "historic and substantial state interest."

Court's Rationale

Nothing in the Washington state law or scholarship program suggested any animus toward religion, the Court noted. The program even included various religious benefits, such as permitting scholarship recipients to attend pervasively religious schools and enroll in devotional theology courses. What it prohibited was the outright distribution of taxpayer funds to support the "essentially religious endeavor of pursuing a theological degree."

"... there are some state actions permitted by the Establishment Clause, but not required by the Free Exercise Clause," the Court explained.

The Court said the Free Exercise Clause and Establishment Clause frequently produce tension between each other, but a 1970 Court ruling observed, "there is room for play in the joints between them." *Walz v. Tax Comm'n of City of New York*, 397 U.S. 664, 669. The Court said this case fits in that category. "In other words, there are some state actions permitted by the Establishment Clause, but not required by the Free Exercise Clause," the Court explained. For instance, although a state government may use public funds to underwrite religious education, as in voucher programs, it is not *required* to do so.

Both federal and state constitutions favor free exercise but oppose establishment of religion, the Court observed. It is therefore permissible for states to prohibit public funding of religious education for the ministry while permitting public funding of education for other callings. Such treatment is not evidence of hostility toward religion and therefore does not violate the First Amendment, the Court concluded. Approximately 36 other states have passed so-called "Blaine amendments" that prohibit funding of religious education with public funds. *Locke v. Davey*, No. 02-1315 (SupCt, 2/25/04).

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Want to know more about religious hiring rights? Order Nonprofit Alert® Memo, *Hiring & Firing: Rights of Religious Employers.*

Salvation Army Faces Legal Battle Over Religious Employees & Government Funding

The New York Civil Liberties Union filed suit against the Salvation Army last month on behalf of eighteen current and former Salvation Army employees, claiming they suffered religious discrimination when they were required to sign a Salvation Army policy requiring them to "preach the Gospel of Jesus Christ." The complaint, filed in federal court in Manhattan, alleges the policy also required employees to list names of churches they previously attended and give permission for religious leaders to disclose confidential communications they may have had with the employees. Some of the plaintiffs claim they were harassed under the new policy until they resigned from the Salvation Army.

The lawsuit focuses primarily on the Salvation Army's operations at its childrens' service agency, based in New York. The agency is the organization's largest publicly financed division in the U.S., receiving some $50 million in government money annually. The plaintiffs claim the charity cannot discriminate on the basis of religion in its employment practices and, at the same time, receive government funding.

The Salvation Army admits it tells applicants and employees the organization is part of the Christian church and asks them to complete a form containing questions on their church affiliations. However, such employment requirements are well within constitutional guidelines for hiring by religious organizations, the Salvation Army explains.

The legal right of religious organizations to make employment decisions on the basis of religion is long established. But this case questions how government funding affects those rights. This same issue stalled the President's initial faith-based legislation until provisions protecting religious hiring rights were dropped.

Liquor Foundation Directors Chug Down $1.5 Million

The New York Attorney General has accepted a $1.5 million payment from six directors of the Grand Marnier Foundation to settle charges that the director received excessive compensation. The settlement also provides that three of the foundation's directors will be replaced by five new board members, according to the Attorney General's office.

Established in 1984 by the U.S. importer of Grand Marnier liquor, the foundation's directors allegedly paid themselves over $3 million in compensation between 1990 and 1999. Generous distributions from a pension plan operated by the foundation accounted for almost a third of the compensation, according to the Attorney General.

The Attorney General determined that at least half of the compensation received by the directors was excessive. The six directors each repaid $250,000 to settle the $1.5 million dispute. The state is holding the repayment in escrow *(continued on page 5)*

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For more helpful tips, review Nonprofit Alert® Memo, *Nonprofit Lobbying and Political Activity – Know Your Limits,* or call the attorneys at Gammon & Grange, P.C.

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FEC Clarifies Advocacy Decision for Nonprofits

The Federal Elections Commission (FEC) has reconsidered an advisory opinion on campaign finance limits that ruffled feathers among nonprofits nationwide when the opinion was published in February. The opinion said campaign finance rules would apply to any communication that "promotes, supports, attacks, or opposes" any federal candidate. Under current campaign finance rules, this means that such communications could not be paid for with donations larger than $5,000 per individual donor.

More than 300 nonprofits complained the opinion was so broadly worded that public service ads and issue advocacy statements could be construed as messages supporting or opposing a candidate, and could thus be subject to the campaign finance rules. Such limits would inhibit public policy work carried on by hundreds of nonpartisan organizations, they argued.

In response, the FEC has issued a statement clarifying that the opinion only applies to political committees registered under §527 of the Internal Revenue Code, but not to any other tax-exempt entities. However, the FEC said it may eventually consider plans for new regulations that *would* cover issue advocacy activity by other exempt organizations if such activity also supports or opposes a federal candidate.

The FEC's advisory opinion, titled "Americans for A Better Country," is available at http://fecweb1.fec.gov/aoreq.html.

IRS Now Accepts Form 990s Online

With tax season upon us, the IRS has announced it will accept electronic Form 990s and 990EZs filed over the Internet. Online filings should be easier and faster, says the IRS, but organizations opting for the online method must use certain IRS-approved software. Currently, the list of approved software providers is rather slim, but the IRS says it's working to approve additional vendors, including at least one that has indicated it will offer the software at no cost to nonprofits.

Organizations that annually submit 990s or 990EZs may now do so online or continue filing the paper versions as they've done in the past. However, private foundations must still file the paper Form 990-PF, as the IRS is not yet able to accept these forms electronically.

The online forms are identical to the printed versions. Nonprofit organizations may use the online 990 Forms in any of the 37 states that also accept the Form 990s to fulfill their own state registration and reporting requirements. The National Association of State Charity Officials worked with the IRS in developing the online forms to meet both federal and state requirements.

To learn more about online Form 990 filing and view a list of approved software vendors, go to http://www.irs.gov/efile.

For help in developing your organization's ethics code, refer to Nonprofit Alert® Memo, *Conflicts of Interest Policy*.

Nonprofit Coalition Releases Model Code of Ethics

Want to do the right thing and follow a code of ethics in your nonprofit, but don't know where to start? Then look no further. Independent Sector, a national coalition of nonprofit organizations, just released a model code of ethics, which it recommends for its members and other nonprofits. The model code includes a set of ethical principles covering:

- personal and professional integrity
- organizational mission and governance polices
- legal compliance and disclosure
- responsible stewardship and fundraising
- inclusiveness and diversity

In the wake of the highly publicized corporate scandals of the past two years, the model code attempts to guide proactive nonprofits and charities in maintaining strong and credible operations. The United Way also voted recently to adopt new ethics standards and impose additional reporting and audit data on its 1,400 agencies nationwide.

Independent Sector recommends the model code for any nonprofit or foundation that's undergoing the process of developing or reconsidering its ethics policies.

The text of the model code is available at http://www.independentsector.org/members/code_ethicsPR2.html.

Liquor Foundation . . . . . *(continued from page 3)*

until all the new board members are in place, after which time the money will revert to the foundation for charitable work.

Under the Intermediate Sanctions law, insiders like the directors in this case are personally liable for repayments of excessive compensation that they receive, along with excise taxes on the amount of excess benefit. Organizational managers who approve such excess benefits are also liable for excise taxes.