



Nonprofit Alert®

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

Nonprofit Overview

Form 990 Disclosure Starts Soon; Nonprofits Brace for Onslaught of Requests. Although it's been nearly two years since the law passed requiring charities to provide copies of their Form 990's to the public, none of its provisions have gone into effect because the IRS has yet to issue final guidance on the measure. IRS officials say the final regs are nearing, however, with some predicting their release within the next month. Once the regs are published, charities will have 60 days before they must begin complying with public requests to disclose their Form 990's. One way to avoid an onslaught of requests is to publish the 990 on your organization's web site or disseminate it through another widely-accessible method. The original legislation includes provisions for this strategy, and IRS officials have strongly encouraged nonprofits to take advantage of this option.

Remember whatever goes on your Form 990 will also go to the public at large, so take extra care in drafting narrative provisions that adequately and accurately reflect the work of your organization. See also *Quote of the Month*, page 4.

Supreme Court Lets Ruling Stand on Church Exemptions from Unemployment Taxes. The Supreme Court refused to hear an appeal last month in a case of significance for churches and church-sponsored groups. The Court's refusal effectively upholds a provision of federal law that exempts churches from the Federal Unemployment Tax Act (FUTA), meaning churches are not required to pay into state and federal unemployment compensation programs. The case arose when a Rhode Island woman filed for state unemployment benefits after being laid off her job with the Salvation Army. (*NPA*, Dec. '97). State officials denied the request, saying she was ineligible since her former employer was a church-operated organization and, therefore, exempt from the state's unemployment compensation program. She filed suit, claiming that federal FUTA provisions were an indirect cause of her denial because they allowed state exemptions for religious employers.

★ **In the lower court proceedings, the First Circuit said the state exemptions under FUTA are constitutional because they have secular legislative purposes. They also improve**

federal and state administration of unemployment programs because they have the effect of excluding workers "whose employment patterns are irregular or whose wages are not easily accountable." *Rojas v. Fitch*, No. 97-1550 (1998), upholding *Guadalupe Rojas v. Lawrence Fitch, et al.*, No. 96-2328 (1st Cir., 1997).

Liability & Risk Management

Museum Audit Uncovers Conflicts of Interest. Arizona State University went public last month with widespread financial discrepancies in its museum management. A state auditor's investigation, begun last spring, found over \$275,000 in museum donations were misdirected to the university's foundation, which handles fundraising for the school and operates under a different set of financial policies than the museum and other university-owned facilities. Funds in the foundation's accounts are exempt from the university's strict spending controls, which apply to all other university-owned facilities. The investigation also found at least nine instances where relatives of museum employees were hired to do additional work for the museum. The university's announcement confirmed the state auditor's findings, but stressed that no misuse of funds or criminal activity occurred.

★ **University officials reinstated the museum director, who had been placed on leave when the audit was released. Officials also said the foundation has now revised its policies for accepting deposits. Additional changes are expected in accounting and depositing earmarked donations.**

Charity Exec, Lawmaker Face Conspiracy Charges. Rabbi Elimelech Naiman, director of employment and training for the Council of Jewish Organizations of Borough Park in New York, has been convicted of bribery and misappropriation of funds. But the state lawmaker, with whom he was accused of conspiring to embezzle government funds, was acquitted. Rabbi Naiman and another organization official were accused of

making illegal payments to State Assemblyman, Dov Hikind (D). They were also charged with misusing organization funds to make personal purchases, including a car, antiques, and tuition. Because the organization annually received millions of dollars in state and federal grants for its job training and elderly support programs, the indictment named the Rabbi and lawmaker, along with another charity official, as co-conspirators. Prosecutors alleged the trio misdirected over \$660,000 in charity funds.

Work Security Sees More Employee Threats.

A survey of Fortune 1000 firms, conducted by the Pinkerton Security Agency, shows that threats from employees account for three of the top five corporate security threats. Employee theft, white collar crime and employee selection head the list, with workplace violence and hardware/software theft rounding out the top five. More sobering is the estimated cost: DOL puts the average cost of hiring a "bad" employee at about 30% of the employee's first year salary.

Manage these risks wisely by making sound hiring and firing decisions. Refer to Memo #9402-1, *Minimizing Liability in the Employment Process*, for more information. See back page to order your copy.

Employees & Volunteers

Employee v. Contractor: Two Taxing Tales. Two recent rulings demonstrate practical applications of the IRS's employee v. independent contractor rules. In the first, the IRS ruled that a presiding elder of a church qualified as an employee rather than an independent contractor, because the church guaranteed him a minimum salary and a retirement plan, plus the church supervised all the services he performed and determined the manner in which his duties were carried out. Therefore, the IRS ruled the elder could deduct certain employee business expenses as miscellaneous itemized deductions. IRS TAM 9825002.

However in the second case, the same rules worked against another taxpayer. A consultant claimed he was an employee of several businesses where he performed various work because each one had established his hours, required him to work on their premises, and did not permit delegation of his duties. But the IRS noted the work was only temporary, and he had specifically reserved the right to engage in other business during each arrangement. His claims were insufficient to establish employee status; therefore, the Tax Court upheld the IRS's assessment of self-employment taxes on the amounts he received for consulting services. *Wright v. Commissioner*, T.C. Memo 1998-224.

In both cases, the IRS's standard 20-point test determined the difference between employee and independent contractor. Learn more about the test and how it applies to your workers with Memo #9110-2, *Will the Real Independent Contractor Please Stand Up?* See back page to order.

Faulty Release Violates Age Discrimination Law. An employee does not waive her rights under the Age Discrimination in Employment Act (ADEA) if she signs a release form that contains legal errors, the Supreme Court has ruled.

In one of the most talked-about cases of the term, the Court also said it doesn't matter if the employer compensated the employee for signing the waiver; a faulty waiver is no waiver. The case provides instruction for all employers that offer early retirement or other severance arrangements for older employees. In return for severance pay when her employment was terminated, Dolores Oubre signed a waiver releasing all claims against her employer, Entergy Operations, Inc. However, the release contained three fatal errors, under the ADEA:

- It did not provide Oubre enough time to consider her options.
- It did not allow seven days to change her mind after signing.
- It failed to reference her specific rights and claims under the ADEA or to recommend that she consult legal counsel.

Lower courts sided with Entergy, but the Supreme Court said a waiver isn't valid unless it's knowing and voluntary. It can't be knowing and voluntary unless "at a minimum it satisfies certain enumerated requirements, including the three listed above."

★ **Entergy argued Oubre's retention of her severance pay was the same as ratifying the release, but the court said no. Furthermore, the court noted that such a policy might actually encourage employers to tempt employees with severance pay for signing faulty releases, then claim ratification after the employees took the pay, knowing that most employees couldn't possibly repay the monies. *Oubre v. Entergy Operations, Inc.*, 118 S.Ct. 838 (1998).**

Tax-Exempt News & Issues

Pooled Income Funds: Merging Into Bigger Pool.

What happens when you develop several successful giving programs, only to find terrible inefficiencies in administering each one? The IRS says: merge. Over several years, a charity created four pooled income funds to attract various donor groups. To cut overhead and streamline inefficiencies, the charity proposed merging the funds and issuing new agreements to beneficiaries, and now, the IRS has fully accepted the plan. IRS LTR 9818048.

Does your charitable giving program include options like pooled income funds? Memo #9301-3, *Pooled Income Funds: Long-Term Fund Raisers for Nonprofits*, offers helpful guidance.

Foundation's Scholarships Pegged With Tax. A private foundation that operated a scholarship program for children of its employees will now have to claim the scholarships as taxable expenditures, after an IRS ruling found the program didn't comply with tax guidelines. Begun in 1993, the program awarded two \$4,000 scholarships annually, to be distributed in amounts of \$500 per semester or \$1,000 per year, provided the recipients' maintained their grades and their parents remained employed with the foundation. If a parent's employment with the foundation ended, then the scholarship continued only for two years. The IRS said this provision did not comply with tax rules.

The foundation also failed to name an independent selection committee to award the scholarships. For these reasons, the IRS ruled the program did not qualify for special treatment as employer-related scholarship grants under the tax code. IRS LTR 9825004.

Learn the in's and out's of employer-provided scholarship program with Memo #9211-2, *Establishing Scholarship & Tuition Reduction Programs*. See back page to order.

From Morbid to Moribund, UBIT Abounds. Recent revenue rulings give a glimpse of the unusual circumstances surrounding some unrelated business income taxes (UBIT). In the first ruling, the IRS approved a 501(c)(3)'s sale of medical literature on developmental deficiencies. Because the organization operated for educational and scientific purposes, the IRS said the sales were related to its exempt function and would not trigger UBIT. In the second ruling, the IRS approved the sale of caskets by a 501(c)(3) that operated a cemetery, since the activity was so closely related to the "disposal of bodies by burial that it [was] incidental to that purpose." All caskets sold were used only for burials inside the cemetery, and all sale proceeds supported maintenance and operation of the cemetery. The IRS concluded the casket sales would not trigger UBIT or endanger the organization's exempt status. IRS LTRs 9821063 & 9814051.

UBIT arises in some of the most unexpected circumstances. Review Memo #9110-1, *A UBIT Primer for Nonprofits*, to avoid problems. See back page to order.

State Rules & Regs

California Nonprofits Face Greater Scrutiny. Under a new measure recently passed by the San Francisco Board of Supervisors, all nonprofit organizations that receive at least \$250,000 a year in city funding must disclose budget summaries and open at least two of their board meetings to the public annually. Exemptions are provided for nonprofits that deal with hazardous or life-threatening operations, such as domestic violence shelters or suicide prevention services.

★ **The measure was sparked by a controversy between activists who charged a large San Francisco AIDS foundation with failure to disclose its financial status. But the measure as written, now applies to about 135 nonprofits that receive city funds.**

Michigan Governor Vetoes Nonprofit Tax Break.

Michigan Gov. John Engler (R) has vetoed legislation that would have exempted churches and religious organizations from state real estate transfer taxes. He opposed the narrowly-carved

NPA Highlight of the Month

Prompted by Scandals and Public Mistrust,

New Ethical Standards Designed for Nonprofit Boards

Amid all the talk about charitable abuses and the public's mistrust of nonprofits, one thing emerges: no clear "industry standards" exist for accountability in the charitable community the way most other trades and professions have established standards. Now, two state associations of nonprofits in Maryland and Minnesota have done something about the void. Both groups have drafted "Standards of Excellence," designed to promote ethics and accountability in the charitable world, especially among nonprofit board members. The standards apply only to nonprofits in those states, but serve as examples for other nonprofits to follow on an individual basis and even adopt among other state nonprofit associations. The Maryland Association of Nonprofits published its standards in June and has begun certifying nonprofits in the state for compliance. Participation is not mandatory, but nonprofits that receive certification are entitled to advertise their compliance status and build on their certification as an indicator of their good reputation and sound business practices. The Minnesota Council of Nonprofits is still in the drafting phase, with a proposal of 90 standards that member groups are now evaluating. The final version isn't expected until October.

★ **The Maryland standards cover everything from executive compensation to fundraising to conflicts of interest. Eight "Guiding Principles" form the basis of the document, which encompass 55 specific "Standards of Excellence." In developing the model, the group drew upon many similar codes of conduct from organizations as varied as the American Cancer Society, the Council of Better Business Bureaus, and the Evangelical Council for Financial Accountability. The intent, says Peter Bern of the Maryland Nonprofit Association, is to provide "very clear expectations about what constitutes good nonprofit management." He believes the benefits are twofold: "The standards provide a valuable service to the donor community in helping them identify well-run nonprofits," but they're also "a very helpful tool for nonprofits to use in raising issues with their boards about how they operate."**

exemption because it would “set a precedent and invite other interests to seek similar special treatment.”

New York Denies Sales Tax Exemption to AARP. A state administrative law judge has upheld the Department of Taxation’s denial of a sales tax exemption to a local chapter of the American Association of Retired Persons (AARP) because the organization did not operate exclusively for an exempt purpose. Although the group provided information services to members, the services did not qualify as educational. Instead, the judge said most of its activities were purely social. *Matter of Northwestern Suffolk AARP*, No. 5053, 5/14/98.

Items of Executive Interest

Quote of the Month. “IT’S THEIR [CHARITIES’] OPPORTUNITY TO EXPLAIN WHAT THEY DO IN RETURN FOR THEIR TAX EXEMPTIONS.”— Marc Owens, quoted in *Chronicle of Philanthropy*, extolling the benefits of Form 990 public disclosure. See related story, page 1.

Best Day to Get Things Accomplished: Tuesday. Maybe you suspected it all along, but now there’s proof people are more productive on certain days of the week. A study by Accountemps, a temporary staffing service, reports the highest levels of employee productivity occur on Tuesdays. Ranking next were Mondays and Wednesdays, with Thursday coming in a distant third. Not surprisingly, the least productive day is Friday.

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