



Nonprofit *Alert*®

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

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➤ From Credit Cards to Mailing List

IRS Concedes Defeat (Almost) in Prolonged Litigation Over UBIT on Royalty Income

IRS officials have confirmed they will not appeal the Tax Court's recent decision in *Sierra Club v. Commissioner*, a five-year battle the IRS waged in an attempt to collect unrelated business income tax (UBIT) on proceeds the club received from an affinity credit card program.

➤ **The IRS may have abandoned its efforts in *Sierra Club*, but the question isn't completely settled yet. On appeal to the Ninth Circuit are two additional cases in which the IRS makes similar arguments. The results will likely be the same, but practitioners are watching closely, hoping "the government stops beating this dead horse," as the *Sierra Club's* attorney says with exasperation.**

The IRS lost another round last month in separate litigation over the taxability of income generated from the rental of mailing lists. The Tax Court ruled that such income classifies as royalties, which are also not subject to UBIT.

The IRS had assessed UBIT against *Common Cause* and the *Planned Parenthood Federation* for mailing list rental income, claiming they were running unrelated businesses. But the Tax Court said not so, finding the rental activity was an intangible asset that produced only royalties.

The court also said that "list brokers" (i.e. professionals who received a portion of the payments in exchange for helping rent the lists)

were independent agents whose income and work could not be attributed to the exempt organizations. This meant the organizations were not liable for tax on income the brokers received, thwarting a secondary argument the IRS had made in both cases. *Common Cause v. Commissioner*, 112 T.C. 23 and *Planned Parenthood Federation of America v. Commissioner*, T.C. Memo 1999-206.

Air Lines, No. 97-1943; *Murphy v. United Parcel Service*, No. 97-1992; *Albertson's, Inc. v. Kirkingburg*, No. 98-591 (S.Ct. 6/22/99).

Postage Refund Due To Some Nonprofits, USPS Announces

The Postal Service's Board of Governors has ruled that some nonprofit periodicals paid a higher rate than required for their nonprofit mailings over the last seven months and are due a refund from the Postal Service. Some of the rates billed to nonprofits were actually higher than what they would've been charged had they mailed the periodicals at regular postage rates, the Board found. The Board also approved a plan allowing nonprofits to migrate back and forth between nonprofit and regular rates, depending on whichever rate is less expensive.

➤ **The refund will be retroactive to January 10, 1999, but nonprofits must apply for reimbursement. Learn more on the "Breaking News" page at <http://www.nonprofitmailers.org>**

~~~~~ **Computer Recycling: It Could Work For You** ~~~~~ DRAGnet, a Minnesota group, is the country's largest nonprofit, EPA-compliant computer recycler. Since its inception five years ago, DRAGnet has recycled over 36,000 computers. Many of these come from corporate America, but have gone back into service in the nonprofit sector. Perhaps a recycled computer could benefit your organization. Contact DRAGnet at (612) 378-9796 or via email at [info@dragnet.org](mailto:info@dragnet.org). Visit their web site at <http://www.dragnet.org>.

## Liability & Risk Management

### Last Call for Telemarketer After Court Ruling

A California appeals court has upheld a lower court ruling that bars an Orange County telemarketing firm and its owner from doing business in the state. The firm, which operates under various names (i.e. Orange County Charitable Services, North American Charitable Services, and U.S. Marketing) first met opposition in 1995 when a California judge ordered the company to account for \$15 million that it purportedly raised for charity. The company continued its controversial operations over the next two years, bringing in an additional \$7 million. The court found that the firm's telemarketers regularly lied to donors and set up phoney charities to which their collections were deposited. The firm's chairman, Mitchell Gold, admitted that the charities he contracts with receive only a small percentage of donations received on their behalf, typically about 10%. Also included in the judgment were Gold's father and several other family members. The Federal Trade Commission (FTC) launched a separate investigation into the firm's practices last year and eventually filed a fraud suit against the firm that is currently pending in federal court.

**Meanwhile, the FTC won judgements last month against two other telemarketers, T.E.M.M. Marketing Inc. and Tri-State Advertising Unlimited for falsely selling ads that were supposed to benefit civic and charitable organizations. No such ads ever materialized. Both firms are now banned from selling ads or soliciting money. The message for nonprofits: carefully check the practices, reputations, and references of any professional fundraiser before signing on the dotted line.**

### Charity Settles Exploitation Charges for \$395,000

The Pennsylvania Attorney General's office has reached a settlement with the American Indian Relief Council that calls for the organization to pay \$395,000 in settlement of charges that it exploited the plight of Native Americans to collect charitable donations, which it then used deceptively. According to state officials, the organization (also known as National Relief Charities) even funneled funds to its directors and officers for their personal benefit. The organization allegedly used direct mail solicitations between 1991 and 1993 to extract money from

donors by describing famine and other deplorable conditions on several Dakota reservations. Such conditions were either blatantly exaggerated or didn't exist at all, according to prosecutors.

**The settlement includes an admission of wrongdoing, plus a repayment of \$350,000 in restitution, which goes directly to three South Dakota reservations. The organization must also pay \$15,000 in civil penalties and \$30,000 for the cost of the state's investigation.**

### Ministry Leaders Guilty of Fraud; Sentenced to Jail

Two officials of the Florida-based Greater Ministries International are now serving prison terms, while seven more officials await trial this month, in the latest developments of a long-running ministry scandal. In June, Patrick Henry Talbert, a former elder with the organization, received a 10-year sentence in state court on conviction of 38 counts of racketeering, conspiracy, and securities violations. Jonathan Strawder, leader of a Greater Ministries spinoff called Sovereign Ministries International, was also sentenced to five years for fraud, plus five years for a federal violation of money laundering, but he is serving both terms concurrently in federal prison. Seven other Greater Ministry officials, including the organization's president and his wife, face federal trials this month for conspiracy, money laundering, and mail fraud. Strawder is cooperating as a witness in those trials with hopes of lessening his prison time, prosecutors said. Greater Ministries came under federal and state investigation last year. (NPA, Apr. & May '99). The organization allegedly ran a six-year scam, preying on Christian investors with promises to double their money in what amounted to a Ponzi scheme.

## Employees & Volunteers

### Not on Payroll? Liable for Discrimination Anyway

An employer may be liable for discrimination against a worker, even if the worker isn't directly employed by the employer, says the Texas Supreme Court. It is enough if the employer "controls access to employment opportunities...or denies...access based on unlawful criteria." The ruling came in a case involving a pathologist who worked for a laboratory. The lab contracted with a hospital to provide various services over which the hospital had broad control, including the right to direct the lab's employees. Several hiring and benefits disputes erupted between the hospital and the pathologist, which eventually prompted the pathologist to sue the hospital for discrimination. A lower court sided with the hospital because there was no employment relationship, but the Texas Supreme Court reversed, finding that the hospital controlled the pathologist's access to employment opportunities and unlawfully interfered or denied that access. *Sierra Medical Center v. Rennels*, No. 98-0487 (TX, 7/3/99).

**A direct employment relationship may not be required for a claim of discrimination to stand. Remember, all employees must be treated fairly, regardless of who their primary employer is. For help, see Nonprofit Alert® Memo 9312-1, *Avoiding Employment Discrimination*. See back page to order.**

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## Telecommuting Holds Pros & Cons for Nonprofits

Some 40% of 133 million employees nationwide could perform their jobs just as easily by telecommuting. In certain white-collar areas like Washington, D.C. and Los Angeles, that percentage could reach up to 60%, estimates the International Telework Association. Nonprofits are ideal for telecommuting because their work often lends itself to off-site arrangements. It's attractive too, since it can significantly reduce a nonprofit's space requirements and/or leasing costs. But there are some risks to consider...

- **Assets:** If employees use assets off-site, like computers or copiers, the organization should track the items and establish a clear policy covering maintenance and repair responsibilities.
- **Agreement:** Ideally, the telecommuting arrangement should be in writing to avoid any misunderstandings. Specify performance criteria, accessibility, intellectual property rights to any products the employee creates, etc.
- **Confidentiality:** Make sure employees understand their confidentiality obligations to protect any sensitive projects, records, etc. they may have off-site while telecommuting.

➔ **To encourage telecommuting in the nation's five most traffic-congested cities, Rep. Frank Wolf (R-VA) has introduced legislation to award businesses and nonprofits "pollution credits" for every employee who telecommutes. The credits could be bought or sold,**

similar to a program run by the EPA, which awards credits for reducing acid rain emissions. Currently, credits in that program are trading at about \$159 each, with a total market value of \$1.4 billion. These could prove to be significant assets for nonprofits.

## Tax-Exempt Issues

### UBIT-Free Mushrooms Generate Exempt Profits

The profits that a mushroom farm and processing facility will produce for an exempt organization are not taxable as unrelated business income (UBI) because the farm and facility are "substantially related" to the organization's exempt purpose, the IRS says. The organization's mission is to rehabilitate individuals suffering from drug-addiction. The farm and processing facility will be used to teach work skills to recovering addicts and other needy individuals. All proceeds generated by the operation will be used to fund the drug recovery facility. This supports the exempt organization's mission, the IRS says. LTR 199920041.

➔ **Just because an activity generates profit or resembles commercial activity doesn't necessarily mean it will produce a tax liability for an exempt organization.**

## NPA Highlight of the Month

### Coming This Fall: Changes in Trademark Law

An amendment to the Trademark Act, set to take effect this fall, contains detailed provisions regarding changes in federal trademark maintenance filings that could affect some nonprofits. The amendment, known as the Trademark Law Treaty Implementation Act (TLTIA), becomes effective October 30, 1999, but many organizations are preparing now for the changes to come. The most striking change mandated by the law is that a "Section 8 Affidavit of Use" must be filed with the U.S. Patent & Trademark Office (PTO) ~~not only between the fifth and sixth years of registration, but~~ every tenth year when the registrant files its "Section 9 Renewal Affidavit," in order to preserve a trademark registration. This applies to any Renewal Affidavits filed on or after October 30, 1999. A "Section 8 Affidavit of Use" is generally used to confirm the ongoing use of a particular trademark, while a "Section 9 Renewal Affidavit" is used to renew a trademark when it expires. New Affidavit forms will be required, along with an increase in filing fees that has not yet been determined. The current PTO fee to file a Section 9 Affidavit is \$300 per mark, per class. An additional change in the law gives trademark holders one year in which to file the new combined Renewal Affidavit, rather than the current period of six months. Renewals must be filed within one year prior to a trademark registration's expiration date, or within an additional six-month grace period upon payment of a grace period fee. Although the changes aren't effective for a few months, practitioners advise exempt organizations to calendar the beginning of the tenth year (*i.e.*, the end of the ninth year) of registration to start the renewal process for each registered mark they hold.

➔ **Note that federal trademark registrations issued or renewed on or after November 16, 1989 remain in force initially for ten years and may be renewed for ten-year periods. Trademark registrations issued or renewed prior to that date remain in force for an initial 20-year period but can only be renewed for ten-year periods. Nonprofit Alert® Memo 9301- 2 provides more details. See back page to order the memo. For help with trademark registration, contact Nancy LeSourd or Rebecca Zachritz at Gammon & Grange, P.C.**

 **The outcome depends on several factors, including whether the activity is related to the organization's exempt purpose and how the profits will be used.**

### **Charity Loses Funding Over Religious Questions**

A North Carolina affiliate of Operation Blessing, a charity that helps the homeless, has lost a \$50,000 federal grant because it asks its clients too many questions about religion, say county officials who administer the federal funds. The organization asks all its clients to complete an application form before receiving housing, clothes, financial help, food or other assistance. County officials cited at least two offensive questions on the form, including a question asking whether applicants considered themselves "saved," and whether they believed they would go to heaven. County officials say the questions violate federal regulations and are refusing to release any further federal funds to the organization, reports *The Washington Post*.

 **Although charitable choice legislation made it possible for religious groups to receive federal funds starting in 1996, this story typifies some of the complications that can arise when religious organizations accept government funds. What can be done? Read Nonprofit Alert® Memo 9702-1, *Charitable Choice—Government Funding to Religious Social Service Providers* for help. See box below to order.**

### **New FASB Rule Addresses Donor-Designated Gifts**

A new rule of the Financial Accounting Standards Board (FASB) gives direction on how charities may count donor-designated contributions (i.e. those contributions earmarked for other organizations or individuals) as public support. This rule, known as Statement 136, expands upon FASB's rule prohibiting a nonprofit from recognizing receipts as contribution income when the nonprofit acts as an agent, trustee, intermediary, or a "mere conduit" for contributions to others. Statement 136 allows a charity to treat transferred assets as contribution income if the donor explicitly grants "variance power," giving the charity unilateral power to redirect the assets to another beneficiary. This power allows the charity to override the donor's instructions without approval from the donor or designated beneficiary.

## State Rules & Regs

### **California Considers Credit for Corporate Donors**

A group of state legislators is calling for legislation that would give corporate donors a 50% tax credit when they contribute to community development corporations or other nonprofits that help improve the state's impoverished communities.

 **At least 12 other states have similar legislation, according to the nonprofit Local Initiatives Support Corporation. Read more at <http://www.liscnet.org>.**

### **Iowa Exempts Museum Membership & Gift Sales**

The Iowa Department of Revenue and Finance has issued a new policy ruling that exempts the proceeds generated by museum membership fees and gift shop sales from state sales taxes. The exemption applies only to the extent that such sales or fees are for educational and charitable purposes, however. IO 99300060.

### **Nebraska Officials Accuse Charity of Funds Abuse**

The Attorney General says the nonprofit Foundation for Educational Funding unfairly denied grants to students at the University of Nebraska in retaliation for the university's participation in the federal direct-loan program. The AG's report says the Foundation engaged in "inappropriate activities" by attempting to lure the university away from the federal program.

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