Gammon & Grange, P.C. August 2001

Nonprofit *Alert*®

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

Inside This Issue:

Faith-Based Legislation Passes House

H.R. 7, the Community Solutions Act of 2001, has cleared a significant hurdle–passage in the U.S. House of Representatives.

The legislation provides tax incentives for charitable giving, and enables faith-based charities to compete with non-religious organizations for certain federal social service funds. (See *NPA*, Apr. 2001).

Revisions

In response to concerns that the faith-based initiatives portion of the legislation might violate the Establishment Clause and undermine various discrimination laws, the House Judiciary Committee revised the measure to: (1) give social service beneficiaries the option to decline participation in religious instruction or worship; (2) clarify that government may provide indirect assistance to beneficiaries through vouchers that can be redeemed with faith-based organizations; (3) clarify that a faith-based organization receiving federal funding may discriminate in hiring on the basis of religion, but may not discriminate on the basis of sex, race, ornational origin; and (4) require that faith-based organizations receiving federal funding must submit annual self-audits to the government.

The Committee's revision also included a $50 million earmark for training and assistance for small social service providers that wish to participate in Department of Justice social service programs.

Charitable Deduction

The House Ways and Means Committee made a further revision to H.R. 7 that substantially scaled back the charitable deduction available to non-itemizers.

The legislation now allows non-itemizers to deduct $25 of charitable contributions in 2002-03, $50 in 2004-06, $75 in 2007-09, and $100 in 2010 and beyond. These revisions lower the estimated cost of this provision from $84 billion to $6.3 billion.

Passage of the Bill

On July 19, the full House approved the Committee-amended legislation with a 233-198 vote. The final legislation includes a number of other tax incentives for charitable giving, including:

- tax-free distributions from IRAs for charitable purposes;
- expansion of individual development accounts;
- increased percentage limitations for corporate charitable contributions; and
- a private foundation excise tax reduction from 2% to 1%.

Uncertain Future

The H.R. 7 legislation has been referred to the Senate, but its passage is uncertain due to the objection of certain Senators who oppose the religious hiring provision, which preserves the right of religious organizations under the 1964 Civil Rights Act to make employment decisions on the basis of religion. Some opponents have argued that the provision is unconstitutional.

To review this legislation or a summary, see the Thomas web site, www.thomas.loc.gov.

➤ **For more information on this and other laws that help enable religious organizations to accept government funds without compromising their religious missions, read Nonprofit Alert® Memo, *Charitable Choice*. Ordering instructions appear on page 4.**

+++Donor Advised Funds Flourish +++

Results in a recent survey conducted by *The Chronicle of Philanthropy* show that assets at many of the nation's largest donor advised funds grew to $10.2 billion last year. Those funds made $1.4 billion in grants to charitable groups. Of the 67 donor advised funds surveyed, nine are offered by nonprofit groups set up by commercial investment companies. The largest of these funds, the Fidelity Investments Charitable Gift Fund, had $2.4 billion in assets and made $574 million in grants to charities during its fiscal year According to *The Chronicle*, the 2000 figures continue a growth trend among donor advised funds that dates back at least to the mid-1990s.

Liability & Risk Management

Director Can't Be Removed Prematurely From Board

A nonprofit board may not remove an elected director from a future term in office, declares a recent opinion of the Alabama Supreme Court. In an election by members of the Emerald Valley Resort Club, a nonprofit corporation, Melissa Walker was re-elected to serve as a director for a three year term effective January, 2000. However, in November, 1999, the club's board of directors removed her for cause from both the term she was serving in 1999 and the future term she had been elected to serve. Walker sued eight of the 10 members of the board. A trial court ruled that the board's removal of Walker from a future term was impermissible and ordered her reinstatement. On appeal, the Alabama Supreme court upheld the lower court's ruling. The court explained the general principle of law that an organization's constitution and bylaws impose contractual duties on the organization, its members, and directors. In this case, the club's bylaws permitted a director to be removed by a majority vote of the remaining directors only "if a director does not perform duties he/she was elected to perform (such as attending board meetings)." Because Walker's three-year term had not begun, she could not yet be in dereliction of her director duties and, therefore, could not be removed, the court ruled. *Dawkins v. Walker*, No. 1991712 (AL Sup.Ct. 2001).

This case emphasizes the importance of drafting governing documents that clearly state the rights and responsibilities of board members. For information on how to prepare organizational documents, read Nonprofit Alert® Memo, *Steps in Organizing a Nonprofit.* See ordering instructions on the back page.

Former United Way President Forfeits $2.4 Million

When former United Way (UW) President William Aramony was convicted of embezzling more than $1.2 million from UW in 1995 and sentenced to prison, he had allegedly accumulated over $4 million in retirement benefits. During his tenure at UW, Aramony lost most of his retirement benefits due to a change in the tax code. He claimed that his benefits were restored by a non-qualified retirement benefit plan (RBP) that UW adopted *before* this tax code change to restore other lost retirement benefits. A lower court held that the RBP, by implication, included replacement benefits for losses incurred because of subsequent tax law changes, but the Second Circuit Court of Appeals disagreed.

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It held that the language of the RBP included only replacement benefits based on specific losses, and did not cover losses from future tax code changes. Thus, Aramony wasn't vested in the RDP and was not entitled to its benefits. A UW representative stated that Aramony, who is scheduled to be released from federal prison on Oct. 1, will be entitled to only $7718 in other pension benefits. *Aramony v United Way of America*, No. 00-

Rabbi trusts or other unfunded retirement plans offer nonprofits some flexibility in structuring deferred compensation beyond standard ERISA plans, but careful planning and drafting is essential. Contact Stephen Clarke for further information at smc@gandglaw.com.

Employees & Volunteers

E-avesdrop Carefully: Inform Employees in Advance

Last month, **Nonprofit Alert®** reported that a study conducted by the American Management Association (AMA) revealed the percentages of employers who monitor their employee communications had increased dramatically in recent years, driven in large part by concerns regarding legal compliance and risk management, productivity, performance and security. The prevalence for monitoring, as reported in the AMA study, highlights the importance of having a prudent policy, reviewed by legal counsel, that governs monitoring of employee email and Internet use. A number of judicial decisions suggest that an employer can significantly reduce its legal liability risks for violating employee privacy rights by informing employees in advance of the employer's monitoring practices.

Gammon & Grange has prepared a brief checklist identifying some of the key elements of a prudent email policy. For a free copy, contact Jo-Anne Kehmna at jak@gandglaw.com.

Title VII & Sexual Orientation: Discrimination?

In a politically-charged case, the Ninth Circuit Court of Appeals has ordered a rehearing of its opinion that harassment of an openly gay MGM Hotel employee by his co-workers did not constitute sex discrimination under Title VII of the 1964 Civil Rights Act. A three-judge panel issued the court's opinion in March; but last month, the court ordered that the case be reheard *en banc*, before an 11-judge panel. The parties do not dispute the existence of a hostile working environment or the fact that the MGM employee was harassed because he was an openly gay man. Rather, they dispute whether Title VII's prohibition of discrimination on the basis of a person's "sex" applies to discrimination based on sexual orientation. In 1998, the U.S. Supreme Court held that same-sex sexual harassment is actionable under Title VII only if a plaintiff can prove that the harasser was motivated by either sexual desire or general hostility to members of that plaintiff's sex.

The Court found that the MGM Hotel employee was harassed because of his
sexual orientation, not because of his sex, and therefore it denied his Title VII claim. The court is scheduled to re-hear the case on September 25. *Rene v. MGM Grand Hotel, Inc.*, No. 98-16924 (9th Cir. 2001); *rehearing en banc order* 7/2/01.

To implement a sound sexual harassment policy in your workplace, read Nonprofit Alert® Memo, *Sexual Harassment Policy: Implement and Educate*.

Tax-Exempt Issues

Prove It or Lose It: Donors Must Keep Records

Arecent Tax Court opinion tells donors they must keep sufficient records, including receipts, if they plan to claim donations as tax deductions. The taxpayers in the case did not obtain receipts for their alleged $8275 in charitable contributions. At trial, they provided only an updated sheet of paper containing various handwritten items and estimated contribution amouts. That was not sufficient, the court ruled, explaining that to qualify for a charitable contribution deduction, a taxpayer must maintain for each contribution a cancelled check, a receipt from the donee organization showing the date and amount of the contribution, or other contemporaneous and reliable written records showing the name of the donee and the date and amount of the contribution. *Gardner v. Comm. of Internal Revenue*, T.C. Summary Opinion 2001-82. As provided in the tax code, a donor may not take a deduction for a single contribution of $250 or more unless the donor substantiates the contribution with a written receipt from the charity. If a charity receives a contribution over $75 that is given partly in consideration for goods or services of more than token value, the charity must provide the donor with a good faith estimate of the value of such goods and services and inform the donor that this portion of the contribution is not deductible.

To make sure your organization is fulfilling its legal duties in receipting charitable contributions, refer to Nonprofit Alert® Memo, *Demystifying the Receipting of Charitable Gifts* for practical tips and helpful insights (ordering instructions appear on the back page). Also refer to IRS Publication 1771 for general guidance (call the IRS at 800-829-3676 to order a free copy of that publication).

NPA Highlight of the Month

Fourth Circuit Upholds State Aid to Religious College, Discards "Pervasively Sectarian" Standard

Using a "neutrality-plus" formula, the Fourth Circuit Court of Appeals recently held that the state of Maryland may allocate funding on a religiously-neutral basis to any college or university, regardless of religious affiliation, as long as the recipient uses the aid exclusively for secular–not sectarian–purposes. Columbia Union College, a college affiliated with the Seventh-Day Adventist Church, applied for a grant from Maryland's Sellinger Program. The program makes payments directly to private colleges within the state that meet six religiously-neutral criteria. The Maryland Higher Education Commission, the program's administrator, denied Columbia's funding request, stating that it was "pervasively sectarian" and was, therefore, disqualified from receiving state funding by the Establishment Clause.

Columbia Union sued Maryland in federal district court. The court held that Columbia Union was not "pervasively sectarian," since it could separate its sectarian and secular activities and allocate state funding solely to secular activities. The Fourth Circuit agreed and upheld the district court's decision. It added, however, that whether or not Columbia Union is "pervasively sectarian" is now irrelevant under recent Supreme Court opinions.

Specifically, the Fourth Circuit interpreted Justice O'Connor's concurring opinion in the Supreme Court's *Mitchell v. Helms* case as "replacing] the pervasively sectarian test with a principle of 'neutrality plus.'" In other words, government does not violate the Establishment Clause if it makes aid available for a secular purpose to a broad range of groups without reference to their religion, and if the government prohibits that aid from being used for religious purposes. In this case, the Fourth Circuit upheld the funding because of the program's neutrality and its safeguards against funds being diverted to religious uses. As of the date of this publication, Maryland state officials have not yet decided whether they will appeal the ruling to the Supreme Court. *Columbia Union College v. Oliver*, No. 96-1831-MJG (4th Cir. 2001).

This decision is an encouraging development for religious organizations that receive or hope to receive government funding. Some legal commentators have questioned whether "pervasively sectarian" organizations are permitted by the Constitution to receive direct government funding. This concern would be alleviated if the Supreme Court were to agree with the Fourth Circuit that the "pervasively sectarian" test is obsolete.

Nonprofit's Surplus Land Sales Result in UBIT

The IRS has ruled that sale of surplus land by a nonprofit organization is deemed to produce income that is subject to unrelated business income tax (UBIT). The nonprofit, in furtherance of its tax-exempt purpose of fostering outreach work, operates a land-purchase program in which it buys land in developing areas, then resells it to newly established nonprofit organizations or schools in the area. In a recent transaction, the nonprofit bought more land than it needed because the seller would only sell the property as a whole. The nonprofit sold the surplus land to a developer and provided the developer with financing. The IRS ruled that the income gained from the sale of the surplus land was taxable because the nonprofit regularly engaged in surplus land sales that were not substantially related to its exempt purposes. IRS LTR 200119061.

Want to better manage unrelated business activity and income? Read Nonprofit Alert® Memo, *UBIT Primer for Nonprofits*. Ordering instructions appear below.

State Rules & Regs

Florida Imposes Property Tax On the Holy Land

Visitors to The Holy Land Experience theme park in Orlando, Florida might see an increase in the park's admission price due to a recent decision by Orange County not to recognize the Christian theme park as exempt from real property taxes. The facility is valued at $16 million, and property tax next year could be as high as $348,000. Florida law provides that property used by educational institutions in Florida exclusively for educational purposes shall be exempt from taxation. Orange County determined that the park was an attraction, not a school or educational institution. The County did grant a tax exemption for portions of the property where educational facilities are located.

The Holy Land Experience Executive Director, Marv Rosenthal, intends to challenge this decision in court. He stated, "We think it's very inappropriate that a museum that teaches about science is tax-exempt, but a museum that teaches about God isn't." The park, which opened in February 2001, recreates settings from Bible times, including a model of Jesus' tomb and a large indoor model of First Century Jerusalem.

Vermont Lobbying Tax Chills Free Speech

The Vermont Supreme Court has struck down a 1998 provision enacted by the Vermont State Legislature which imposed a 5% tax on annual lobbying expenditures exceeding $2,500. The plaintiffs, seven associations, argued in court that the lobby tax would chill political speech in violation of the First Amendment. The Vermont Supreme Court agreed, stating that "the lobby tax plainly warrants heightened scrutiny, under which it cannot pass constitutional muster." The court noted that such taxes "could effectively destroy the right to petition one's government." *Vermont Society of Association Executives v. Milne*, No. 2000-32 (VT Sup.Ct. 2001).

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August 2001

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