Gammon & Grange, P.C. August 2003

# Nonprofit *Alert*®

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

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## *Crimes Against Nature. . .*
## Senate Investigates Insider Deals at Nature Conservancy

The Nature Conservancy, the country's largest land conservation group, is under investigation by the Senate Finance Committee for potential tax law violations. Earlier this summer, the Committee sent an inquiry to the Conservancy that contained more than 100 questions regarding alleged benefits to Conservancy trustees and senior staff.

Articles in the *Washington Post* triggered the inquiry, alleging Conservancy "insiders" received below-market-value property sales and home loans. The articles also alleged the Conservancy compromised its mission by drilling for oil and mining coal on lands that it purchased for conservation.

As part of its "conservation buyer" program, the Conservancy purchased land for conservation, then offered that land for sale to select individuals, including board members and senior staff, for substantially less than fair market value. The Conservancy claims the land's fair market value was reduced by conservation easements that limited the land's development potential. Those easements, however, did not restrict buyers from constructing homes – and in some cases guest cottages, garages, swimming pools, docks, and other recreational facilities.

> "Insiders" allegedly received below-market-value sales and loans. Some transactions also involved payments mischaracterized as charitable donations.

According to the *Post*, some of the Conservancy's land transactions involved payments mischaracterized as charitable contributions from private buyers or sellers. For instance, a $64 million deal involving the Conservancy's purchase of land on Martha's Vineyard hinged on an $18.5 million charitable gift made to the Conservancy two days before closing. The Conservancy allegedly used this gift to buy the land from business entities owned by the same family that donated the money.

Many buyers of conservation property allegedly made contributions to the Conservancy that were equivalent to the difference between their property sales price and its fair market value, then took tax deductions for their contributions. The *Post* also reported the Conservancy made 12 home loans to senior staff, many of them at below-market interest rates for homes worth over a million

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# Liability & Risk Management

## NICHE Fights for Nonprofit Health Benefits Law

With health insurance premiums for small employers rising 15% to 35% over the last three years, Congress is considering legislation that would permit association health plans ("AHPs") representing small organizations to operate under the same rules that govern large employer health plans.

The bill, known as the Small Business Health Fairness Act, passed the House in June and is now under consideration in the Senate. Sponsors of the legislation project cost-savings of 15% to 30% for small businesses if the bill becomes law.

Unfortunately, the bill does not expressly state coverage for small nonprofit employers. This means insurance carriers could refuse to recognize nonprofit entities as qualifying AHPs under the Act, leaving out more than 15 million employees and family members.

Gammon & Grange has organized a group of concerned nonprofits called the NICHE (Nonprofit Insurance Coverage for Healthy Employees) Coalition, to persuade the Senate that revisions should expressly include nonprofit entities.

*For more information on the NICHE Coalition, and to learn how you can help other nonprofits level the playing field in providing competitive health insurance benefits, contact Steve Kao at (703) 761-5000 x129 or ssk@gg-law.com.*

## N.Y. Regulator Pushes for Tougher Charity Rules

In a controversial push for increased charitable giving regulation, New York's Attorney General, Eliot Spitzer, has asked Congress to:

(1) ban small private foundations (i.e. organizations with $20 million or less in assets);

(2) amend federal law so that donors could not deduct the portion of their gifts that end up in the hands of professional fundraisers;

(3) allow the IRS to share information about tax-exempt organizations with state charity regulators; and

(4) provide the IRS with new enforcement tools against private foundations that give their executives excessive compensation.

*At least 45 states, plus the District of Columbia, now regulate charitable solicitations with a myriad of state rules and regulations.*

Spitzer has also announced that his office will enforce a current law that requires professional fundraisers to submit any "written" scripts used to solicit donations. Previously, Spitzer proposed new audit committee standards, internal control procedures, and rules requiring charities to obtain multiple bids before entering fundraising contracts in New York. (See Nonprofit *Alert*®, Apr.'03).

Currently, charitable solicitations are regulated on a state-by-state basis, with 45 states and the District of Columbia now imposing some form of charitable solicitation regulation. In addition, scores of municipalities have adopted their own fund raising regulations.

## Associations Oppose H.R. 7 Provision

Two prominent associations serving the nonprofit community, Independent Sector and the Council on Foundations, recently announced their opposition to Section 105 of the Charitable Giving Act (H.R. 7). As reported in the July 2003 *Nonprofit Alert*®, this section of the pending legislation would prohibit private foundations from applying administrative expenses, such as rent and salaries, toward their annual charitable distribution amounts.

Currently, private foundations are required by federal law to distribute 5% of their net assets to charities or other qualifying recipients each year, but administrative expenses may be included in that amount. The new legislation would limit those expenses only to direct charitable distributions.

According to a study by the National Committee for Responsive Philanthropy (NCRP), this limitation would ultimately boost charitable funds by $4.3 billion annually. But the Council on Foundations argues the provision would compromise the long-term viability of charitable endowments by eroding them to cover administrative expenses. The Council also believes the provision would discourage foundations from incurring administrative expenses for research, technical assistance, due diligence, and communication with the public and policymakers.

**A related debate involves the appropriateness of private foundations providing compensation to their directors and trustees, many of whom are founders of the foundations or founders' family members. To help ensure legal compliance by your nonprofit foundation, see Nonprofit Alert Memo, *Compensation Policies and Legal Guidelines for Nonprofit Leaders*.**

# Tax Exempt Issues

## IRS Closes Curtain on Nonprofit Stock Option Plans for Employees

Stock market doldrums have sucked much of the wind from the sails of high flying employee stock options. Now the IRS has sheared the sail. Last month, the IRS issued final regulations on Section 457 deferred compensation plans for tax exempt organizations. The regulations effectively require the recipient of a stock option to include the value of that option in the recipient's taxable income *at the time the option is granted*, instead of later when the option is exercised.

> *... recipients must now include the value of stock options in their taxable income at the time the options are granted, rather than when the options are exercised.*

In an effort to compete with the for-profit sector, a growing number of nonprofits now provide employee options to purchase an interest in mutual funds or other stocks owned by the nonprofit. Prior to these new regulations, employees were generally able to defer taxation on qualified stock options until those options were exercised.

According to Danny Miller, a Washington, D.C. tax attorney, stock option plans that do not involve a substantial risk of forfeiture will result in the value of stock options being taxable at the time the options are granted. This comes as a direct result of these new regulations.

Critics argue the regulations shouldn't apply to stock options because options consist of a property transfer described elsewhere in the Tax Code. Public comments to that affect were well received by the IRS, with the IRS even indicating it agreed with that rationale. However, the IRS issued the final regulations stating that Section 457(f) applies too! Consequently, employees of tax exempt organizations are now required to report income to the IRS upon receipt of stock options.

Given the serious impact of the new regulations, tax-exempt organizations should review the merits of issuing stock options to their employees and decide whether to continue such plans.

**To receive a free memo summarizing these regulations and their potential effect, contact Gammon & Grange's Steve Clarke at (703) 761-5000 x141 or smc@gg-law.com.**

## *Highlight of the Month*

### President Supports Religious Hiring Criteria for Faith-Based Groups

The White House Office of Faith-Based and Community Initiatives has released a booklet explaining why faith-based organizations that receive federal funds are entitled to take an employee's faith into account when making employment decisions.

The booklet, *Protecting the Civil Rights and Religious Liberty of Faith-Based Organizations*, expands on the President's Executive Order 11246, signed in December 2002, which prohibits federal agencies from discriminating against faith-based organizations in awarding and administering government contracts. It explains the Bush administration's position that government must protect the ability of faith-based organizations to maintain their religious identity, mission, and hiring practices when they receive federal funds.

The booklet also clarifies the administration's position that religious organizations should not be allowed to discriminate against recipients of their services on any basis, including religion, when such organizations receive government funds to provide social services. Nor should they be allowed to use federal dollars to support "inherently religious activities." It is available online at http://www.whitehouse.gov/government/fbci/booklet.pdf.

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## *Nature Conservancy . . .* *(cont. from page 1)*

dollars. The corporation's president, Steven McCormick, admits receiving from the Conservancy a home loan of $1.55 million, at an interest rate of 4.59 %– described by mortgage specialists as being below fair market value at the time. The Conservancy says all but two of these loans have been paid off.

Now, the Conservancy's Board of Governors has discontinued loans and land sales to its employees and trustees. It no longer accepts charitable contributions in connection with its conservation buyer program, nor does it conduct drilling or mining on its properties. The board also hired independent advisors to help review governance and oversight policies. The Senate Finance Committee continues to investigate potential illegal conduct by the Conservancy and is seeking cooperation from the IRS.

**Lessons to Learn**

A nonprofit, tax exempt corporation is prohibited from generating "private inurement," or excess benefit, to the corporation's directors and other insiders. This investigation underscores the importance of adopting and following a thoughtful conflicts of interest policy to avoid generating private inurement.

Your board must ultimately ensure, through reasonable policies and proactive reporting from management, that all transactions between your organization and any third parties are fair and reasonable. Most importantly, any transactions with insiders must be reviewed carefully to ensure that no excess benefits (*e.g.*, sales of property for less than fair market value) are given to insiders. Otherwise, both insiders and directors who actively or passively allow these transactions could be subject to excise taxes under intermediate sanctions rules.

**For more help, order Nonprofit Alert® Memos, *Governing Responsibly by Nonprofit Board Members*, and *Intermediate Sanctions Law*. See ordering information in the box at right.**

## *Would "Death Tax" Kill Charity Giving?*

According to a recent report by OMB Watch, a government watchdog group that opposes repeal of the federal estate (a.k.a. "death") tax, such repeal would result in a 22% decrease in total charitable bequests – a loss of up to $6 billion a year. The group cites figures showing that estates with significant tax liabilities give between two and three times as much to charity as estates without tax liability. Supporters of estate tax repeal contend it would allow donors to give more by protecting their charity-bound dollars from the government.

Under current law, the estate tax exclusion gradually increases until 2010, when the tax would be repealed for one year. In 2011, the estate tax repeal legislation would sunset, and new legislation would be required. Otherwise, the estate tax would be restored. The House of Representatives has approved legislation repealing the tax, but the Senate is not expected to follow suit.





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