



# Nonprofit *Alert*®

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

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## Nonprofit Overview

### *Church Liable for Negligent Supervision, After Mom Intervenes to Save Son's Job*

The Ohio Court of Appeals has reversed a lower court and held a church liable for negligent supervision and retention of a teenage employee who worked for the church as a youth child care assistant. The teenager was found guilty of sexually molesting nine children over a four year period. Guardians of the nine victims brought suit against the church for failing to properly supervise the teenager and failing to take proper disciplinary action based on the teenager's work performance. The record indicated parents complained and a supervisor observed the teenager's inappropriate behavior, but when the teenager's mother intervened, he was allowed to continue working. A lower court dismissed the claims because the church had a policy that prohibited youth assistants from being left alone with children. But the appeals court said the policy was irrelevant when "it was clear from the record that [the teenager] managed to circumvent the policy on numerous occasions." The appeals court also permitted the victims to collect punitive damages against the church. *Doe v. First Presbyterian Church (USA)*, No. 97-CA48-2 (OH Ct.App. 1998).

★ **Here, the employer had adopted a child abuse policy but failed to enforce it consistently. The mistake was further compounded when the church reinstated the teenager at his mother's insistence, then relaxed its supervision, permitting him to be alone with the victims.**



Practical suggestions for preventing offenses like these in your organization are offered in NP9611-1, *Preventing the Risk of Child Abuse*, and NP9611-3, *Responding to Indications of Child Abuse*. See back page to order both memos. Federal law requires background checks of all employees who work with children. Now the Volunteers for Children Act, enacted last year, also requires background checks for volunteers who work with children. Learn more about this law at a web site operated by the National Foundation to Prevent Child Sexual Abuse: <http://www.childsexualabuse.org>.

### **1999 Surprise: Reimbursement Rate Up & Down**

If your account managers are accustomed to increasing mileage and per diem rates every year, here's a big heads up: they didn't all go up this year! The mileage rate actually went down, from 32.5¢ to 31¢ per mile for business travel. However, the new rate isn't effective until April 1, 1999 (another unusual twist, since the IRS generally puts all rate changes in effect at the beginning of the year). The mileage rate for charitable use of autos remains unchanged at 14¢ per mile. Per diem rates, however, all went up. For high cost areas, the rate went from \$180 to \$185 per day. For all other areas, the rate increased from \$113 to \$115 per day. In addition, several cities were removed from the high-cost list, including Los Angeles and Santa Fe, meaning per diem for travel to these cities no longer qualifies for the higher rates. But several others were added to the high-cost list, including Gulf Shores, Ala., Yosemite National Park, and Wintergreen, Va. IRS Rev. Proc. 98-63 & 98-64, Ann. 99-7.

★ **This marks the first time the IRS has ever lowered the mileage rate over a previous year's rate. Lower oil prices reportedly accounted for the decrease.**



For a complete discussion, order NP9103-3, *Expense Reimbursement for Volunteers and Employees*.

## Liability & Risk Management

### **Criticism on Tape Leads to \$1.2 Million Settlement**

The Los Angeles County Board of Supervisors and the AIDS Healthcare Foundation have agreed to settle a legal dispute out of court for \$1.2 million. The foundation brought suit against the county last year when it obtained tape recorded comments by government officials saying funding to the group was cut because its officers had publicly criticized the county's handling of federal AIDS funds.

★ **Sunshine laws generally require most government board meetings to be taped or open to the public, but the practice isn't always preferable for nonprofit meetings. Consider the meeting topics and participants before taping.**

### **Charities Potentially Liable for Abusive Tax Shelters**

Creative fundraising can be risky: the IRS has announced it will apply §6700 and §6701 penalties against any charity that misrepresents charitable deductions with the purpose of creating tax shelters for donors. Those sections of the tax code were originally enacted to stop the tide of abusive tax schemes popular during the 1980's, but the IRS says it will use these provisions to enforce penalties against charities that promote or organize any arrangement that amounts to an abusive tax shelter, such as overstating the value of donated goods so donors can claim greater deductions, or providing inaccurate information to donors about the deductibility of their contributions.



**For more information, read IRS publication, Tax Topic 454: Tax Shelters, available at [http://www.irs.ustreas.gov/basic/tax\\_edu/teletax/tc454.html](http://www.irs.ustreas.gov/basic/tax_edu/teletax/tc454.html)**

### **Housing Allowance: Must Name It To Claim It**

Ministerial housing allowances must actually be designated in advance for clergy to claim the tax benefits associated with them. The church or parish that provides the allowance must make the designation via an employment contract, board minutes, or some other official document, but a W-2 form issued at the end of the year isn't sufficient, the Tax Court ruled in a recent case. The ruling forced a minister and his wife to pay back taxes and penalties on \$15,000 in income that the IRS determined was not exempt as a housing allowance. The minister's wife testified that she had read about housing allowances in the tax code and thought they could include it on their tax return. Based in part on

her testimony, the court ruled the allowance was nothing more than an afterthought since no evidence existed to prove the church officially designated the payments as a housing allowance. *Logie v. Commissioner*, T.C. Memo 198-387.

★ **Under the tax code, the taxpayer—in this case, the minister and his wife, not the church—bear the burden of proving the housing allowance was officially designated. Make sure you're following all the rules with NP9101-5, Ministerial Housing Allowances: Qualifying & Documenting. See back page to order.**

## Employees & Volunteers

### **You've Got Mail . . . But Does the Boss Know?**

The average office worker sends and receives 30 emails a day, according to a study by Pitney Bowes, but it's not all business related. Employers translate that into lost production, which leads many to implement monitoring programs that screen non-work related emails. Employees cry "privacy invasion," and legal disputes often erupt. The last two years have seen a rash of such cases in lower courts at both the state and federal levels. Many are currently on appeal so the outcome is still unclear, but one thing is certain: employers are well advised to take precautions before instituting any kind of workplace surveillance that could improperly infringe on their employee's civil rights. As a minimum, employers should:

- establish good business reasons for instituting any type of monitoring or surveillance programs;
- clearly and completely document and inform employees of such programs upon implementation, and thereafter, provide the same information to all new hires;
- obtain written agreements from employees, stating that they consent to such monitoring; and
- establish proper policies for handling whatever information is collected through such programs.

★ **Experts estimate the number of email messages sent and received by the typical office worker will triple by the year 2002. Already, the length of email messages has increased by 30% over 1996 averages.**

### **Employers Still Struggle With New Hire Reporting**

It's been over a year now since the federal law went into effect requiring all employers, including nonprofits, to report new hires. The measure is intended to help courts enforce child support orders against non-compliant parents, but many employers are still confused. Under the federal law, employers must report new hires within 20 days of hiring by submitting their W-4 forms or an equivalent form with the same information to a designated state agency. Failure to do so results in fines and penalties levied against the employer for \$25 to \$500 per employee.



**Some states impose shorter deadlines, so check with agency officials in your state. A list of all state contacts in the designated reporting agencies is accessible at <http://www.acf.dhhs.gov/programs/cse/newhire/nh/statcont.htm>.**

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## Tax-Exempt Issues

### *Bowling League Strikes Out on Tax Exemption*

The IRS has revoked an amateur bowling organization's tax exemption, finding it was not operated for charitable purposes and that it engaged in private inurement to the benefit of its officers. The organization was formed to "develop volunteer coaches in the sport of bowling and to provide training and competition for young amateur bowlers." The organization raised money by selling pickle cards (a game of chance) at local bowling alleys. Funds raised went to a bowling league supported by the organization, but in reality, the league was controlled by the organization's founder, who operated the league for profit purposes at the bowling alley he owned. He and other officers of the organization also received personal payments through the league that were not documented for charitable purposes. IRS LTR 9851001.

★ **In this classic case of inurement, not only did the founder personally benefit, but his business—the bowling alley—also benefited from increased publicity and patronage.**

➔ See warning lights when considering any kind of venture between a nonprofit and an insider or a business of the insider (or family member). Always consult legal counsel before proceeding. NP9109-4, *The Essential Don'ts of Private Inurement*, provides helpful guidelines. See back page to order.

### *Charity Exec's Royalties Get IRS Royal Treatment*

Ordinarily, royalties paid to an individual are considered compensation, which can sometimes result in prohibited private inurement if they're paid by a nonprofit. But the IRS recently granted approval to a special royalty arrangement between a public charity and its past president that actually benefited a number of charities. The president authored certain medical literature and evaluations to be used in identifying development disorders in children. Because the charity's exempt purpose was to increase public awareness of developmental disorders, the charity entered an agreement with the president to sell his materials. In return, the charity paid royalties to various charities picked by the president and his wife. The president received no further compensation. Two issues caught the IRS's attention: whether the sale resulted in unrelated business income (UBI) taxable to the charity, and whether the royalty arrangement created prohibited private inurement. In both instances, the IRS ruled in the charity's favor. IRS LTR 9851052.

★ **The products were so closely related to the charity's exempt purpose that their sale didn't result in unrelated business income, the IRS said. Since the president received no compensation from the deal, the IRS could identify no private inurement. The arrangement passed IRS scrutiny on both counts.**

➔ UBI continues to be a perennial problem for nonprofits, especially those that enter profit-making ventures like this one. Understand the basic prohibitions with NP9110-1, *A UBIT Primer for Nonprofits*. See back page to order.

## *NPA Highlight of the Month*

### *IRS, States Take a Long Look:*

## **Automobile Donations Under Regulation**

The days are gone when you simply traded in your old jalopy for a new sports car. Now, charities nationwide are vying for your used automobile. The trend has taken hold as all kinds of charities from social service organizations to public radio stations solicit used car donations. The practice is not without its downside, however, as the IRS and many state regulators question the propriety of such donations and who they ultimately benefit. Recently, California enacted legislation imposing strict reporting and receipting requirements on nonprofits that accept vehicle donations. Receipts provided by nonprofits must describe the vehicle, its age, mileage, condition, defects, and operability. Nonprofits are also required to disclose the percentage of the contribution that will be used for charitable purposes. Legislators enacted the law after finding that commercial fundraisers solicited car donations on behalf of California nonprofits in 1996 that produced \$11.1 million when they were eventually sold. However, only \$2.1 million (about 20%) of the proceeds ever made it to the charities. Besides increasing state regulations, the IRS imposes certain reporting requirements. For instance, charities must file Form 8282, *Donee Information Return*, upon disposal of a donated vehicle if the claimed value is \$5,000 or more. The form states how much the charity collected for the vehicle, which may be more or less than what the donor intends to claim as a deduction. The IRS may then use this information to challenge a donor's deduction. Although the Service recently announced it will determine a vehicle's fair market value on a case-by-case basis, the IRS cautions that the charity's selling price on an automobile is a good indication of its fair market value, which is all a donor is entitled to deduct. CA SB 1836, Chapter 29. IRS SCA 1998-022.

★ **The tax code requires charities to provide receipts for donations of \$250 or more. But if the donation is valued at more than \$500, the taxpayer must submit additional paperwork to claim the deduction. If the claimed value is \$5,000 or more, the donor must submit proof of value certified by a qualified appraisal which must be completed at or near the time of the donation.**

➔ The federal receipting requirements are outlined in NP9505-1, *Demystifying the Receipting of Charitable Gifts*. See also NP9109-6, *Gifts of Property*, for a discussion of the risks to avoid when nonprofits accept vehicles or other property as donations. Both memos are available from Gammon & Grange. See back page to order.

## State Rules & Regs

### *Texas Shields Nonprofits From Donor Disclosure*

The state supreme court says Texas nonprofits cannot be forced by lawsuit to disclose the names of their contributors because it violates their constitutional rights to freedom of association. A citizens group sued a Texas nonprofit, claiming it had misused government funds and facilities. The citizens wanted the nonprofit to disclose its donors, but the nonprofit objected on constitutional grounds, and the state supreme court unanimously agreed. *In re Bay Area Citizens Against Lawsuit Abuse*, No. 97\_0812 (TX Sup.Ct., 12/10/98).

★ **The court said only a “reasonable probability” must exist to show that compelled disclosure will cause reprisals to donors in order to be unconstitutional. Here, the nonprofit met that standard when it produced letters containing boycott threats to its sponsors and their businesses.**

### *Oklahoma Exempts Youth Camps From Sales Tax*

The state legislature added an amendment to its tax code that exempts from sales taxes any property or services sold to youth camps “supported or sponsored” by churches or church organizations. The amendment specifies that “supported or sponsored” means members of the church must serve as trustees of the camp in some capacity. OK HB 2426.

**Ordering Information:** Memos referenced in the *Nonprofit Alert* are \$20 per memo *prepaid* (\$10 for firm clients). Five or more copies of the same memo are bulk priced at \$5 each.

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### *Virginia Taxes Meals to Employees & Volunteers*

The Virginia Department of Taxation has ruled that a nonprofit hospital must collect sales taxes on the cost of free meals it provides to employees and volunteers at its on-site cafeteria. The meals were provided in conjunction with hospital-related seminars and training, but the department nevertheless determined they were taxable transactions. Note these same meals should be exempt from federal taxes under IRC §119.

**Quote of the Month.** “WHAT IT BOILS DOWN TO IS THAT NOBODY SHOULD HAVE THIS MUCH MONEY. WE LIVE IN A CULTURE THAT TEACHES PEOPLE TO BECOME SUCCESSFUL BUT NEGLECTS TO TEACH THE RESPONSIBLE USE OF THAT SUCCESS.” — James E. Rogers, Chairman Sunbelt Communications, on his reasons for donating substantial sums to the University of Arizona.

### *Nonprofit Revenue Triples in Twenty Years; Outpaces GDP*

Latest figures released by the IRS show that assets and revenues of tax-exempt organizations increased by 300 percent between 1975 and 1995, while during that same period, the nation’s GDP increased by only 74%.



**The IRS now operates a toll free hotline especially for nonprofit tax questions: (877) 829-5500.**

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(Nonprofit Alert Memo #9612-1)

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