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Nonprofit Alert®

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

Inside This Issue:

Congress Works to Reconcile Charity Bills

One of the most significant developments in the charity world last year was passage of charitable legislation in the House (i.e. Charitable Giving Act) and Senate (CARE Act). This legislation has stalled, however, as the House and Senate attempt to reconcile differences between the two bills. According to staffers, only 12 of the 42 charitable tax provisions are consistent in both bills. That leaves the bulk of this legislation to be ironed out in conference. The differences include:

- **In-Kind Donations** - The Senate bill enhances charitable deductions for contributions of books and food; the House version only includes deductions for food. Both expand deductions on contributions of scientific property and computer equipment, but only for educational uses.

- **Private Foundation Excise Tax** - The House version reduces private foundation excise taxes on net income; the Senate proposal omits this provision. The House bill restricts administrative expenses that can be included in private foundations' annual payout figures, and raises the self-dealing tax from 5% to 25%. The Senate bill doesn't address those concerns.

> Only 12 of the 42 charitable tax provisions are consistent in both bills.

- **Disclosure** - The Senate bill addresses disclosure requirements for charities, which the House bill omits. The Senate bill requires charities with annual incomes under $5,000 to file a simplified annual "postcard" return with the IRS. Currently, these organizations are exempt from filing annual returns. The Senate bill also provides for automatic revocation of the exempt status of any charity that fails to file its required annual returns (including the new postcard returns) with the IRS for three consecutive years.

One problem slowing the reconciliation progress is the lack of offsets to pay for incentives provided in the bills. According to staffers, one option currently under consideration involves changing the valuation methods for property donations, especially intellectual property like patents and trademarks that have an easily determined basis value but undeterminable value when estimating future royalty income.

Just last month, the IRS announced plans to crack down on improper deductions that taxpayers are claiming for intellectual property donations. Expect more developments as legislators and regulators get involved.

Liability & Risk Management

Acting Against Lawyer's Advice Constitutes Breach of Fiduciary Duty, Court Rules

Your lawyer knows best, says a Pennsylvania appeals court in a ruling that holds church leaders liable for a breach of fiduciary duty for failing to follow their lawyer's advice. The case involved an Episcopalian church that sought separation from the Episcopal Diocese of Pennsylvania over theological differences.

Fearing the Diocese would claim all the church's property, the church vestrymen established a foundation for the sole purpose of receiving and holding church property. Their plan was to transfer everything into the foundation and effect a merger between the church and foundation, which would limit the Diocese's access to the property. But their attorney advised against the action and suggested they file a property claim to quiet title. The vestrymen rejected his advice and instead entered the merger.

The court said the vestrymen acted in bad faith by rejecting the lawyer's advice. Because the foundation was established for a purpose completely different from the church's purpose, the court noted that the transfer of church property and the ensuing merger required court approval under state law. But the vestrymen did not obtain such approval. This and other acts inconsistent with the lawyer's advice suggested that the foundation was "void at its inception" and "a byproduct of the deception of the vestrymen," the court wrote.

Such behavior evidenced bad faith, which constituted a breach of fiduciary duties, the court said. Four of the 12 vestrymen were held personally liable. The court said all twelve were jointly liable, but it upheld the lower court's assessment of damages only against the four vestrymen who actually participated in the merger action. *Appeal of Church of St. James the Less,* No. 629, Penn. C.D. 2003 (10/7/03).

Legal Lesson: Fiduciary Duty to Act

In this case, the court considered the church vestrymen to be much like a board of directors or trustees with fiduciary duties that require an individual to act in the best interests of the organization. As such, the vestrymen couldn't fulfill their fiduciary duties merely by acquiescing with their attorney. However, it was the vestrymen's complete disregard of the attorney's advice, along with their deceptive attempts to make an unauthorized merger with a foundation, that the court held to be a breach of these fiduciary duties.

Your board should consider the recommendations of outside advisors when appropriate, but if those recommendations aren't accepted, then fully document the board's specific rationale for acting against such advice. Documentation should be clear in board minutes or other board records. This careful attention to detail could help your board to support its decision if challenged.

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Supreme Court Set to Hear Workplace Harassment Case

Read the Third Circuit's opinion in Suders v. Easton

A case scheduled to come before the Supreme Court this session may define new areas of employer liability for sexual harassment. The case arises from the Third Circuit Court of Appeals ruling that a constructive discharge is a "tangible employment action." Based on that assumption, the Third Circuit permitted a female employee, who voluntarily quit her job, to sue her employer for harassment.

The employee sued the Pennsylvania State Police department, where she worked as a dispatcher. She claimed her male bosses told dirty jokes, made sexually provocative gestures toward her, and prodded her to perform sex acts. Her complaints to the department's EEO officer were ignored. She finally quit after five months on the job when her boss accused her of stealing her personnel files. During the accusation, she was handcuffed at the office, photographed, read her rights, and questioned but never charged with any wrongdoing.

> Does a constructive discharge amount to a "tangible employment action?"

Two landmark Supreme Court rulings in 1998 held employers liable if a "tangible employment action" resulted from harassment, *even if* the employer's senior management was unaware the harassment took place. Here, the employee asks the Court to find she was constructively discharged and consider it a "tangible employment action." If the Court rules in her favor, it would effectively expand the 1998 ruling to include employees who quit their jobs because they have no other option when faced with continued harassment.

The case is *Penn. State Police v. Suders*, No. 03-95, on appeal from the Third Circuit ruling in *Suders v. Easton*, No. 01-3512 (3rd Cir, 4/16/03). A ruling by the Supreme Court is expected before July, 2004.

Negotiating Period Opens for 2005-06 Webcasting Royalty Rates

For more information, contact Gammon & Grange's IP attorney, Ken Liu at (703) 761-5000.

Digital transmissions of sound recordings–or webcasting, as it's commonly known–is a staple on many web sites today, but copyright laws complicate the practice by requiring the payment of compulsory license fees. All webcasters must either pay the mandatory fees or obtain permission from the sound recording copyright owners. If your organization transmits music on its web site, and has not complied with the statutory webcasting license terms and paid the mandatory fees, it could be subject to a copyright infringement suit.

In 2003, the Recording Industry Association of America negotiated rates for small and noncommerical webcasters as an alternative to the generally decried high rates set by the U.S. Copyright Office. Last month, the Copyright Office announced the beginning of the period for voluntary negotiation of alternative 2005-06 license rates and terms. The negotiation period began on January 6, 2004 and runs through June 30, 2004. It remains to be seen whether the new, small, and noncommercial rates will be any lower than the 2003-04 rates.

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Nonprofit & Tax Exempt Issues

Are you capitalizing on this surge in volunteerism? Learn how to best manage volunteers. Order Nonprofit Alert Memo, *Managing Volunteers.*

Up by 6% Over Prior Year, Record Numbers Volunteered in 2003

A new government study reports that 63.8 million Americans volunteered in some capacity last year–a record high, according to the Department of Labor's Bureau of Labor Statistics. The number of volunteers is up by 6% from the same period a year earlier, says the study.

The biggest increase came among teenagers who volunteered at a rate of nearly 500,000 more than in years prior, an increase of 11%. Female volunteers outnumbered men by 32.2% to 25.1%.

Echoing those trends, another study conducted in late 2003 by Harris Interactive reveals that 50% of Americans think volunteering for charity is more important than making financial contributions to a charity. The poll also revealed additional findings that provide insight into the public's changing perception of volunteering:

- 22% of respondents said monetary donations were the most important thing they could give to charities.
- 23% said contributions of time and money are equally important.

IRS Must Disclose Reasons for Revocations, Court Rules

A federal appeals court has ordered the IRS to fully disclose its reasoning for granting or revoking exempt status. Until this ruling, the IRS routinely withheld such information from the public or heavily redacted private letter rulings and other documents concerning exemption rulings. Some charity leaders have criticized this practice as denying the nonprofit community access to information that could help organizations with similar activities learn vicariously from the experiences of others.

The U.S. Court of Appeals for the District of Columbia ruled that the IRS must now make full disclosure of its reasons for granting or denying tax exemptions, but that the IRS could still redact the names of organizations and individuals to protect their privacy. The ruling requires the IRS to make available for public inspection "any document" issued by the IRS addressing an organization's exempt status.

Experts say the decision will be most helpful to charities in new or cutting-edge areas of charitable activity to discern patterns and standards the IRS uses in granting or revoking tax exemptions. Tax Analysts, a nonprofit publisher in Washington, D.C., filed the case against the IRS. *Tax Analysts v. IRS*, No. 02-5278 (D.C. Cir. 12/2/03).

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Highlight of the Month

Georgia Settles Religious Hiring Case Involving Gay Rights Group

Georgia's Department of Health and Human Services has agreed to an out of court settlement in a controversial employment discrimination case involving a lesbian counselor and a Jewish therapist who sued the state and the United Methodist Children's Home. Lambda Defense Fund, a gay rights group, filed the case on behalf of the two plaintiffs, claiming the state unconstitutionally granted government funds to the Home and the home unconstitutionally discriminated against the counselor and therapist. Allegedly, the home fired the counselor because she was a lesbian, and refused to hire the therapist because he was Jewish.

The settlement includes new rules that prohibit child care and child welfare programs in Georgia from using government funds for religious activities, including religious worship, instruction, proselytization, or promotion. The rules also prohibit employment discrimination on the basis of race, sex, national origin, and religion against paid or volunteer staff members of such child care and child welfare providers that receive state funding.

The new rules provide a limited religious hiring exemption for faith-based organizations. "Such entities may consider religion in the hiring or appointment of any positions serving a primarily spiritual, ministerial, or religious purpose," the settlement states, "[but] under no circumstances will any government monies, either directly or indirectly, fund or support the employment of such non-secular positions, or any of the non-secular programs and services that they provide." Child care and child welfare programs are also now required to maintain on file with the Georgia Department of Health and Human Services a list of all staff positions that serve a primarily spiritual, ministerial, or religious purpose for which an exemption from the new rules is claimed.

Courts across the nation have long upheld the right of faith-based groups to use religion as a factor in hiring or firing employees, though some courts have upheld provisions in government grant agreements prohibiting recipients from discriminating on the basis of religion in making employment decisions. As a response to the imposition of this religious hiring restriction, the Georgia General Assembly is now considering legislation that would strengthen the ability of faith-based organizations to use religion as a criterion in making employment decisions.