



# Nonprofit *Alert*®

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

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Car Donations: Don't Get Taken for a Ride!

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## IRS Focus for 2002:

### Religious & Social Service Groups

Religious organizations and social service groups take note: the IRS plans to conduct six "market segment" examinations during the coming year, according to Thomas J. Miller, a manager in the IRS Exempt Organizations Division. Each market segment exam will generate about 150 audits in each of the following Section 501(c) categories:

- clubs;
- labor organizations;
- business leagues;
- community trusts;
- social service groups; and
- religious groups separate from churches.

Market segment exams are intended to help the IRS learn about a particular market and determine whether compliance issues exist in those markets that must be addressed by education, guidance, or enforcement. That means these exams could produce additional IRS oversight of other nonprofits in those categories.

#### Long Term Implications

While it's too early to speculate on results, the possibility of focused IRS attention in specific market segments holds significant long term implications for those nonprofits now

undergoing strategic posturing and long range planning processes.

#### Topics of Focus

Other issues the IRS will focus on for the coming year, according to Miller, include donor-advised funds, debt-financed property, and political contributions. He said the Service hopes to issue final regulations on intermediate sanctions and corporate sponsorship, which have

raised many concerns among exempt organizations in recent years.

He also said the IRS wants to identify certain safe harbors that exempt organizations may use when encountering UBIT issues, particularly those that arise when using expense allocation formulas.

An earlier publication listing the IRS's priorities for 2002

*(continued on back page)*

### Note on Form 990 Creates Confusion

A note at the top of Schedule B, Schedule of Contributors, for the Form 990 is causing confusion among exempt organizations preparing to file their tax forms this year, reports the IRS.

The note says, in large, italicized type, "This form is generally not open to public inspection except for section 527 organizations."

But in fact, only certain identifying information provided on Schedule B is not open for public inspection, such as contributors' names and addresses. These are protected from disclosure for privacy reasons. Any other information on Schedule B is

subject to public disclosure, including amounts and totals of contributions.

The note is not as "precise" as the IRS would like it to be, an IRS spokesperson admitted, but still-to-be-printed instructions to the form are expected to clarify the statement.

➤ **Pay careful attention to the information you include on Schedule B, remembering that it's even available online now via [www.Guidestar.org](http://www.Guidestar.org) with only the items mentioned above redacted.**

### ➔➔➔ Art Does It's Part for Nonprofit Support ←←←

Every year, more than 5,000 students from The Art Institute, a nationwide system of 23 schools, donate design and development services to nonprofits seeking web sites, PSA's, videos, and advertising materials. Students benefit from the hands-on experience, and nonprofits get a creative product at little or no cost. For example, students at the Art Institute of Pittsburgh designed comic books for local drug rehab and domestic violence centers to help educate clients. For more info, call (800) 328-7900.

## Liability & Risk Management

### Creditors Can't Reach Parent Nonprofit's Assets

When can a nonprofit be liable for the debts of its affiliate? When it holds some sort of "equity interest" in the affiliate, the 6<sup>th</sup> Circuit Court of Appeals has ruled in a case involving an international labor union sued for debts owed by its bankrupt local affiliate. The case arose when Local Teamsters Union #890 led a strike against California growers. Violence erupted, the growers sued and eventually won judgment against the local union for more than \$1.3 million in damages. The local filed for bankruptcy, proposing to mortgage all its properties, but could cover only \$300,000 of the growers' claim. The growers challenged the plan, claiming the International Teamsters Union was obligated to put up more cash because its contract required that the local's assets be distributed to the international if the local ever dissolved. The growers argued that this "equity interest" was sufficient to financially obligate the international to prevent the bankruptcy. The court disagreed: That argument might make sense in a for-profit context, if a corporation's equity owners share responsibility for its bankruptcy; but not in the case of an exempt organization, where the only interest the international had was "a highly conditional, future interest ...[which was] remote at best." Neither the international union nor the union's members had an ownership interest because they did not share any profits or control assets of the local, the court concluded. *In re: General Teamsters, Warehousemen and Helpers Union, Local 890*, No. 99-17030 (6<sup>th</sup> Cir. 9/10/01).

 **This ruling suggests a nonprofit may have less exposure for an affiliate's debts than a for-profit might have, but it also means that control of an affiliate's assets or operations could expose the controlling entity to liability for the affiliate's debts.**

### Circular Reasoning? Company Shares, Then Sues

"Good fences make good neighbors," so the saying goes, but it doesn't apply just to real estate; it's true for intellectual property too, as this case proves. The Circle Line Sightseeing Company is suing the Circle Line-Statute of Liberty Ferry over rights to use the "Circle Line" name. Since the 1940's, Circle Line ferry boats have been a common sight in New York Harbor. The founders named the original water tour company "Circle Line Sightseeing Yachts, Inc."

Then in 1953, they founded another company, "Circle Line-Statue of Liberty Ferry," which provided service to Ellis Island. Both companies operated independently for decades. But after the Sept. 11 attacks, the Statue of Liberty and Ellis Island closed to the public, thrusting the ferry into precarious financial waters. To survive, the ferry began operating harbor cruises in direct competition with Circle Line Sightseeing. Now, rough seas lie ahead as the two companies fight over the name in federal court. Circle Line Sightseeing claims that Circle Line-Statue of Liberty infringed its service mark when it entered the sightseeing cruise business. *Circle Line Sightseeing Yachts Inc., v. Circle Line-Statue of Liberty, Inc.* No. 01-CV-9788 (SDNY. 11/6/01).

 **The lesson here: never, never "share" a trademark, especially if the entity happens to be in the same or similar market. If infringement occurs, swift action is the only way to protect these important assets, as detailed in Nonprofit Alert® Memo, *Trademark Law for Nonprofits*. See back page to order.**

## Employees & Volunteers

### Point of No Return: FMLA Demands Performance

The Family & Medical Leave Act (FMLA) does not guarantee an employee's job will be restored if, at the end of the FMLA leave period, the employee is unable to perform essential functions of the job, the 8th Circuit has ruled in a case of first impression. FMLA merely allows an employee to be away from the job for family and/or medical reasons without the threat of losing that job due to the absence, the court explained. But "while the employee is at his or her job, the employee must be able to perform the essential functions of the job," the court said. In this case, a college business manager suffered a work-related head injury, which left her with the ability to perform only routine tasks. Her doctor said she could not fully discharge her job duties for at least six months after the injury, and recommended that she not meet with students or attend staff meetings. The college then put her on full-time leave, and nine months later, eliminated her position during an administrative restructuring. The college offered her three other part-time positions, but she refused them all. She sued, alleging FMLA violations, among other charges. She claimed she could've returned to work once her FMLA leave expired if the college had allowed "work hardening" (i.e. work on a reduced schedule, gradually building up to her previous full-time standards). The court rejected her argument, finding that FMLA only "protects an employee who must leave work, or reduce his or her work schedule, for medical reasons, as long as that employee can perform the job while at work." Because she was unable to perform essential functions of her job as business manager when her leave ended, she was not entitled to job restoration under the FMLA. For similar reasons, neither could she make a claim under the Americans With Disabilities Act that "work hardening" was a reasonable accommodation. *Hatchett v. Philander Smith College*, No. 00-1693 (8th Cir 6/1/01).

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 In a recent study, 51% of business managers ranked the FMLA as the federal regulation that “causes the biggest headache.” Nonprofit Alert® Memo, *FMLA Compliance*, provides a primer on this complex law. See back page to order your copy today.

### ***Arbitration Enforced Despite Employee Reluctance***

Two recent cases out of the 4<sup>th</sup> Circuit bolster the reliability of arbitration agreements. In both cases, the court forced employees to arbitrate their discrimination complaints, despite questions about the validity of the agreements. The first case involved a human resources director who signed a document containing a mandatory arbitration clause, then later filed an EEOC complaint against her company for gender and age discrimination. The company responded with a federal lawsuit alleging conspiracy to injure its business reputation. The company also argued that the employee’s complaints were barred because she didn’t first enter arbitration. The 4<sup>th</sup> Circuit overturned the lower courts’ ruling in favor of the employee, finding that although the company had undertaken a “remarkably aggressive” course of litigation designed to wear out the employee, both parties were required to submit their claims to arbitration first. *Microstrategy, Inc. v. Lauricia*, No. 00-2297 (4<sup>th</sup> Cir, 9/27/01).

The second case involved a manager at an Olive Garden Restaurant who attended a mandatory weekly briefing where the restaurant’s new dispute resolution procedure (DRP) was briefly announced. He signed an attendance sheet at the meeting, which stated that he was present and received the

DRP information.

Three months later, he submitted claims of racial and religious discrimination to be resolved under the DRP program. When no settlement was reached, he filed a federal lawsuit, and claimed he’d never consented to the DRP agreement. But the court remanded the case and compelled arbitration because it found a valid arbitration agreement existed from the time of the weekly briefing. The manager’s continued employment after receiving the briefing and signing the attendance sheet constituted his agreement to be bound by arbitration. The fact that he’d brought his initial claim under the DRP program also suggested he had ample understanding and knowledge of the agreement in the first place, the court reasoned. *Hightower v. GMRI, Inc.* No. 01-1302 (4<sup>th</sup> Cir 11/14/01).

 **Arbitration and mediation often provide a positive, cost effective means of resolution. Even though courts are split in how far they enforce arbitration provisions in a discrimination context, these cases show they are increasingly willing to sustain arbitration. Does your organization have a valid arbitration agreement in place? Order Nonprofit Alert®Memo, *ADR: Arbitrate, Don’t Litigate*, for more information. See back page to order.**

## ***NPA Highlight of the Month***

### **Perils of Joyriding: IRS Cautions Car Donation Programs**

A nine-step checklist published recently by the IRS raises awareness about appropriate procedures in charity-run car donation programs. Concerns about fraud and misrepresentation in some of these aggressively marketed programs led to the IRS’s consumer caution. For charities operating car donation programs, it’s wise to be familiar with the checklist so donors are confident that exempt purposes are adequately being served. Note especially these points from the checklist:

- **Claim Only Fair Market Value.** A charitable deduction is only allowed for the fair market value of an automobile, not the full “Blue Book” value, as some programs advertise. Fair market value may or may not equal “Blue Book” value, depending on many factors such as the condition of the vehicle, etc. The IRS offers two publications, Pub #526 *Charitable Deductions* and Pub #561 *Determining the Value of Donated Property*, that help explain fair market value.

- **Obtain Proper Documentation.** The taxpayer must obtain adequate documentation of the donation and its fair market value. Otherwise, the IRS may disallow the gift as a charitable deduction. IRS Pub #526 *Charitable Deductions* also describes the types of receipts that taxpayers must have in order to properly claim the deduction.

- **Remember State Law.** In general, most states require the donor to transfer the car title to the charity, but some states make exceptions. Check with legal counsel to determine the particular requirements in your jurisdiction. Donors should also remove the license plates before transferring the car to a charity in order to avoid liability issues.

The checklist also advises donors to contact state charity and IRS officials when in doubt about the legitimacy of a used car donation program.. This is important for nonprofits to keep in mind, since it suggests that, in addition to establishing a program with integrity, nonprofits would be well advised to show donors that appropriate accountability mechanisms are in place, which enable their programs to clearly and responsibly further their charitable purposes.

 The nine-step checklist appears in IRS News Release #IR-2001-112. All IRS Publications are available on the IRS web site at [www.irs.gov](http://www.irs.gov). Also check Nonprofit Alert® Memo, *Charitable Gifts: Receiving & Receipting*, for information on how to provide proper receipts. See back page to order.

### ***Donations of Employee Leave Stimulate Q's & A's***

Leave-based donation programs, begun by many employers after the Sept. 11 attacks as a way for employees to make contributions to relief organizations, won't generate taxable income to employees, the IRS has announced. The programs work by having employees forgo vacation, sick, or personal leave in exchange for contributions their employer makes to a charity of their choice. Employers and employees had questioned whether the IRS would impute constructive receipt of income or wages to employees who participate in such programs, thereby making employees liable for employment taxes on the amounts contributed. The IRS decided it will not impute income to employees, but employees cannot claim charitable tax deductions for the value of their leave donations either. Instead, the employer may claim a regular business expense for the contributions. IRS Notice 2001-69.

 **This interim guidance is effective only until Dec. 31, 2002. In the meantime, the IRS is calling for public comments to determine whether a permanent exception for leave-based donation programs should be implemented. The IRS has also requested information about the types of leave donation programs employers are offering.**

## Tax-Exempt Issues

### ***Aggressive Solicitation Law Partially Overturned***

A federal district judge in Tampa has reversed an earlier ruling and has struck down a Pinellas County, Fla., ordinance that required fundraising consultants to register with local officials. American Charities for Reasonable Fundraising Regulation, a coalition of national charities, challenged the ordinance as unduly burdensome for solicitors and fundraisers. The court rejected only the portion of the ordinance that required fundraising consultants to register before conducting solicitations. However, the registration requirement for solicitors remains largely intact. The court focused on the distinction between "fundraising consultants," who merely help charities plan and manage fundraising campaigns, versus "professional

solicitors" (such as telemarketers), who actually ask for donations on behalf of charities. The court reasoned that Pinellas County could not exercise jurisdiction over fundraising consultants since they "are not sufficiently involved" in actual solicitations. This is another in a long series of court challenges to local solicitation laws. A separate lawsuit against Pinellas County, which challenges this same ordinance on free speech grounds, is still pending.

 **Pinellas County's aggressive regulations burdens charities all across the country. Charities should remain aware of their obligations to comply with registration requirements throughout the country— as well as the significant registration exemptions that may also apply. These obligations often vary depending on whether fundraising consultants or solicitors are used. For a 50-state summary of these requirements, order Nonprofit Alert® Memo *Charitable Solicitation Laws: A Multi-State Summary*.**

### ***IRS Plans for 2002 . . .*** *(continued from page 1)*

also referenced plans to partner with organizations that share the IRS's enforcement concerns such as state attorneys general.

► **Worried about an IRS audit? Nonprofit Alert® Memo, *Preparing the Nonprofit for an IRS Visit*, helps answer questions. See ordering instructions in the box below.**

**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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