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Nonprofit *Alert*®

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

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Court of Appeals Ruling:

Church Loses Exemption After Politicking; IRS Revocation Upheld

The first church ever to have its tax exempt status revoked by the IRS for engaging in political activity, lost its federal court appeal last month. The court found the revocation was constitutional and with-in the IRS's power.

The Church at Pierce Creek, also known as Branch Ministries, lost its tax exemption in 1995 after it ran prohibited political advertisements during the 1992 presidential campaign.

The ads, which appeared in several national newspapers, opposed then-candidate Clinton's position on a number of issues, including abortion and sex education in public schools. The ads also solicited contributions for their cost.

The IRS began a church tax inquiry, triggered by the ads in late 1992, then launched a full scale examination in 1993. The IRS eventually concluded that the ads were a prohibited intervention in a political campaign. The church challenged the IRS's ruling but lost its case in lower court. On appeal, the church claimed the IRS did not have authority to revoke its exempt status, that the revocation violated its First Amendment rights, and that the IRS engaged in selective prosecution when it penalized the church. The U.S. Court of Appeals for the District of Columbia affirmed the lower court's ruling on all three points raised by the church.

"Because of the unique treatment churches receive under the Internal Revenue code, the impact of the revocation is likely to be more symbolic than substantial."

— Senior Circuit Judge Buckley, writing for the majority.

IRS authority to revoke a church exemption is provided by various statutes in the Internal Revenue Code (IRC), the court said. The court agreed with the IRS that the IRC expressly prohibits churches and all other §501(c) organizations from engaging in any political activity on behalf of or in opposition to a candidate. The IRS then acted accordingly in revoking the exemption, the court concluded. On the constitutional challenge, the court ruled that revocation of the church's exemption would only be a violation if the exemption itself was conditioned upon conduct proscribed by a religious faith. The court found no such condition here because the revocation resulted only in lost revenue for the church, not a violation of beliefs.

The church also failed to establish that it was singled out for prosecution from among others who were similarly situated, the court determined.

The court did, however, opine that the church could regain its exempt status immediately (since churches don't have to file to be exempt) if it merely refrained from continued political activity. *Branch Ministries, et. al. v. Rossotti*, No. 99-5097 (D.C. Ct.App. 5/12/00).

+ + + Gift Annuity Values On the Rise + + +

In just five years, the average dollar value of charitable gift annuities rose a whopping 59%, according to a recent survey by the American Council on Gift Annuities. The survey captured data from 1994 to 1999. Religious organizations came out on top as the largest issuers of these charity instruments, but the average value of annuities held by religious organizations was only $19,325, compared to $47,482 at private educational institutions, and $68,893 at public colleges and universities.

Review Nonprofit *Alert*® Memo, *Guidelines for Charitable Gift Annuities,* for general info (see back page to order). Contact the Council at (317) 269-6271 for details about the study.

Liability & Risk Management

Board Immune From Whistleblower's Claim

When a secretary sued a county tourism board for wrongful discharge, the board members claimed immunity under state law, which provided uncompensated officers and directors immunity from lawsuits arising from the conduct of their official duties unless such conduct was willful, wanton, fraudulent or grossly negligent. The secretary argued immunity didn't apply in this case because she alleged her termination was in retaliation for exposing ethics violations of the tourism board and its executive director. The state's whistle blower law should supersede the immunity law, she argued. Not so, said both the trial and appeals courts, which found the secretary failed to allege any "willful, wanton, fraudulent or negligent activity." As a result, immunity applied. The court also observed that the whistleblower statue was written long after the immunity law, but nothing in the whistleblower statute implied it was meant to preclude a director's immunity. *Thompson v. Colbert County Tourism and Convention Bureau*, No. 2981320 (AL Ct. App., 2/11/000).

Uncompensated board members typically enjoy this type of immunity in most states, but don't count on it to shield you from an intentional retaliation claim. Because retaliation is, by its very act "willful" in nature, most courts would likely find such behavior outside the scope of immunity for directors. Learn more with Nonprofit *Alert*® Memo, *Legal Duties of Nonprofit Directors.* See back page to order.

Domain Name Protected From Garnishment

A creditor seeking to collect a judgment against a debtor cannot garnish Internet domain names that are registered to the debtor, says the Virginia Supreme Court, because those names are not property or liabilities but rather products of a service contract. In a case of first impression, the court overturned a lower court ruling that gave Umbro, Inc., a sportswear company, the right to garnish domain names held by a Canadian company. That right arose from a federal court ruling, which held the Canadian company liable for trademark infringement when it used "umbro.com." In that case, the company was ordered to pay Umbro damages but apparently never complied. Finally, Umbro filed a garnishment action to collect its judgment. The garnishment suit was filed in Virginia, home of Network Solutions, Inc. (NSI), the entity that registered the Canadian company's domain names. Umbro sought to force NSI to sell all the domain names it held for the Canadian company, which included such lucrative titles as "picsofchics.com" and "pornplaza.com." The proceeds would then be used to satisfy Umbro's judgment. However, the Virginia court said that NSI maintained a contract for services with the Canadian company. Therefore, the domain names at issue were not property to be garnished or sold in satisfaction of a judgment. The court said they were the products of the contract for service between NSI and the Canadian company, which Umbro could not reach. *Network Solutions, Inc. v. Umbro Int'l, Inc.*, VLW 000-6-077 (2000).

While this case suggests domain names aren't legal property subject to creditor's claims (at least in Virginia where this case took place), it can be argued that they embody an entity's commercial goodwill, which may be entitled to other legal protections.

Charities Suspiciously Report No Fundraising Costs

One in four charities claim they spend nothing on fundraising when they complete their tax forms, according to a recently released study conducted by *The Chronicle of Philanthropy*. The study looked at data submitted for the 1996 tax year (the most recent year from which tax data is available) by charities that receive at least $500,000 in contributions from private sources. The study results are alarming because they suggest that charities either don't understand their fundraising reporting requirements under current tax laws or intentionally don't comply. In either case, the public stands to be misled by the lack of reliable information. Failing to report accurate fundraising costs makes a charity look more efficient than it really is. It may also make other charities that *do* disclose their full fundraising costs less attractive to donors.

With wider dissemination of charitable tax data on the Internet, there's an even greater push to fully disclose accurate data. A new law, effective earlier this year, requires broad disclosure of Form 990 financial data. Read a full summary in Nonprofit *Alert*® Memo, *Nonprofit Disclosure Rules.* See back page to order.

Employees & Volunteers

Stop the Bus: Work Pay Includes Transport Time

Employees who were required to ride a bus provided by their employer to and from work sites must be compensated for the time spent on the bus, according to the California Supreme Court, because the bus time was part of the employees' "hours worked." Royal Packing, a produce company, required its field workers to assemble at a designated place each morning, where they met the company bus that transported them to and from various fields for work. Because of work and safety policies, employees were prohibited from driving their own autos or arranging their own transportation. State law requires compensation for employees during the time they are "subject to the control of any employer, including all the time the employee is suffered or permitted to work, whether or not required to do so." The state court ruled that the field workers were under Royal's control while they were on the company bus, and they were precluded from other activities they

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might enjoy if they used their own transportation, such as running errands. *Morillion v. Royal Packing*, 22 Cal 4th 575 (2000).

Does your organization provide transportation for employees? This decision could affect nonprofit employers like camps that transport counselors or to camp sites, religious organizations that convey missionaries on-site, or health organizations that dispatch personnel to field work. Check your state wage laws to be sure of your liabilities.

Choir Director Fits Ministerial Exception to ADA

A choir director who "participated in religious rituals and had numerous religious duties" qualified as a "minister," and therefore, could not sue her church for a violation of the Americans With Disabilities Act (ADA). The director claimed her church unreasonably refused to revise her work schedule while she recovered from knee surgery. She sued under the ADA, but a lower court sided with the church, finding that her position fell within the First Amendment ministerial exception to the ADA. On appeal, the Fifth Circuit upheld that ruling, noting that the exception applied to all church employees, "whether ordained or not, whose primary function served its spiritual and pastoral mission." The court observed that the director was required to complete extensive training in theology, plan worship liturgy, and coordinate activities relating to the music ministry. The director even admitted her position included a "ministerial presence." *Starkman v. Evans*, 1999 U.S. App. LEXIS 33989 (5th Cir. 1999).

Tax-Exempt Issues

Sweepstakes Okay (Not to Be Confused With Raffle)

Raffles, lotteries, and other similar games of chance are popular fundraisers. But donors can't deduct the price they pay for tickets because the IRS does not consider them "gifts," since donors merely purchase a chance to receive something of value. However, a recent IRS letter ruling shows how one university devised a sweepstakes program to receive *deductible* charitable contributions. The university mailed free sweepstakes tickets to its past contributors and others on its mailing list. Literature that arrived with the free tickets encouraged recipients to make a tax deductible contribution to the university, but did not require such contributions to participate in the sweepstakes drawing. The literature also clearly stated that a recipient's chance of winning was not affected in any way by whether or not a donation was made. To participate in the drawing, recipients sent their sweepstakes tickets back to the university, where they were all gathered in a secure box and held until the drawing date. The IRS decided this plan was markedly different from the kinds of raffles and lotteries that have traditionally been non-deductible because recipients did not purchase the sweepstakes tickets. No payment of any kind was required to participate; any contribution the recipients made was purely voluntary and was, therefore, deductible as a charitable contribution to the university. IRS LTR 200012061.

NPA Highlight of the Month

Old Computers May Not Be Heaven Sent

Computer carnage—that's the term some organizations have adopted for all the useless computer equipment that gets dumped on nonprofits in the name of charitable donations. While some equipment can be salvaged and put to good use, most of it is either broken beyond repair or outdated beyond hope. Groups like Goodwill and the Salvation Army receive a disproportionate amount of these "contributions," often because donors don't know what else to do with them. Charities then face the problem of properly disposing the items that can't be used, especially items that contain environmentally hazardous substances like lead that's found in old monitors. State lawmakers are also adding to the complications. Massachusetts recently became the first state in the country to ban from its landfills the glass picture tubes found in computer screens and televisions. Six other states have similar legislation pending. North Carolina and California lawmakers are debating proposals that would require manufacturers to take back old equipment and properly dispose of it. Some commercial companies specialize in computer recycling, but it's still relatively new and until it proves profitable, it probably won't be readily available. One solution is being tried in King County, Washington, where the solid waste division of the local government launched a computer recovery project aimed at collecting the recyclable plastic and metal parts of computer equipment, then remaking it into products like asphalt and roofing. If the project proves successful, computer recycling may eventually become a local government initiative, but until then, nonprofits should be cautious.

Since state laws regarding computer disposal are in their infancy *and* since there aren't many good commercial or nonprofit options yet for dealing with this problem, be mindful of the kinds of equipment your organization accepts as donations. A comprehensive non-cash gifts policy should be adopted to deal with these and other property gifts in a thoughtful and systematic way. If a "donated" computer works and meets the needs of your organization, great. But consider how long and how well it will work. If it's only going to meet your needs for a short time, the disposal problems may well outweigh its short term benefits. See Nonprofit *Alert*® Memo, *Gifts of Property* for guidance.

Hospital Retains Property Exemption, Despite Profit

Eaton Hospital, a nonprofit Pennsylvania organization, keeps its property tax exemption after a ruling by the state's supreme court determined that loans it made to another nonprofit health organization and its for-profit subsidiaries actually furthered the hospital's exempt purpose. Local government officials attempted to levy property taxes on the hospital because it did not operate "entirely free from private profit motive," as required under a landmark 1985 Pennsylvania Supreme Court ruling. They claimed the hospital violated the "profit motive" aspect of that precedent when it made loans (some of which were not repaid) to for-profit entities. However, the court saw things differently. It noted that the loans actually resulted in increased efficiency and improved care at the hospital because they reduced the patient load in the emergency room and helped serve low-income patients who didn't have ready access to the hospital. Thus, the hospital qualified as a "purely public charity," entitled to the state's property tax exemption, the court ruled. *Wilson Area Sch. Dist., et. al. v. Easton Hospital*, J-253-98 (PA 2000).

Cap on Charitable Immunity Damages May End

A bill to remove the damages cap on charitable immunity claims is under consideration by the House Judiciary Committee in the state of Massachusetts. Currently, state law limits to $20,000 the amount a plaintiff can collect against a charity for any negligent action. The proposed bill would entirely remove that cap in cases involving willful, wanton, reckless, or gross negligent conduct. (H. 808). Rep. Steven Angelo, the bill's sponsor, says the present cap favors large nonprofits and doesn't protect the public. Several other bills are pending to revise or increase the cap if this bill fails.

Massachusetts is one of the few states that still offers this high degree of charitable immunity, but it likely won't be around much longer. Staffers suggest that H. 808 or some version thereof will be reintroduced again next session if it doesn't pass this time. The charitable immunity cap in its present amount has been on the state law books since 1971.

State Rules & Regs

Arkansas Just Says "No" to Blanket Exemption

An advisory panel of the state legislature has decided against granting a blanket sales tax exemption to charities in Arkansas. Currently, the state grants exemptions only on an individual basis. Advocates for the blanket exemption said the current system often results in exemptions only for those charities that lobby or manage to secure a legislative sponsor. Those opposed to the measure worried that it would cover some charities that shouldn't qualify for sales tax exemptions. State officials estimated the blanket exemption would have cost about $10.9 million in lost taxes.

Virginia Tax Filing Deadline Fast Approaching

Charities exempt from Virginia's sales and use taxes must file updated information by July 1 to maintain their exemptions. The state legislature passed a measure last year requiring all organizations exempt from sales and use taxes under the educational, medical-related, civic and community service, cultural and miscellaneous categories to submit new information to the Department of Taxation as if they were re-applying for their original exemptions. (*NPA*, June'99). After this initial updated filing, charities will be required to re-file every five years.

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