Gammon & Grange, P.C. June 2004

Nonprofit *Alert*®

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

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IRS Sends its Election Year Warning Shot Regarding Charity Politicking

The IRS has issued its normal election year advisory reminding IRC section 501(c)(3) organizations (including churches) of the prohibition against participation or intervention in any political campaign on behalf of, or in opposition to, any candidate for public office. The advisory notes that 501(c)(3) organizations "cannot endorse any candidates, make donations to their campaigns, engage in fund raising, distribute statements, or become involved in any other activities that may be beneficial or detrimental to any candidate."

This year's advisory also warns of potential loss of tax exemption and assessment of penalty taxes for violations of the prohibition.

IR-2004-59 is very similar to election year advisories issued in 1992, 1996, and 2000, noting that while organizations may sponsor debates or forums to educate voters, such activities are prohibited if they show a preference for or against a certain candidate. This year's advisory also warns of potential loss of tax exemption and assessment of penalty taxes for violations of the prohibition. It also adds a reference to the 2000 federal Court of Appeals ruling upholding the revocation of tax exemption a church that placed a newspaper ad critical of Bill Clinton just prior to election day in 1992.

➥**The full IRS advisory can be found at http://www.irs.gov/newsroom/article/0,,id=122887,00.html For more information on political and lobbying activities by nonprofit organizations, order Gammon & Grange's Nonprofit *Alert*® Memo, *Nonprofit Lobbying and Political Activity - Know Your Limits*.**

DOL's New Rules Limit Wage/Hour Exemptions

The Department of Labor ("DOL"), in its "Fairpay Overtime Initiative," has revised its rules and regulations for determining which professional, executive, and administrative employees may be exempt from Fair Labor Standards Act ("FLSA") minimum wage and overtime pay requirements. The revised rules, which take effect on August 23, 2004, generally narrow the scope of FLSA wage/hour exemptions. *(continued on page 2)*

Nonprofit & Tax Exempt Issues

Wage/Hour Exemptions.....[continued from page 1]

Minimum Salary for Exemption Increased:

Under the FSLA, an employer is exempt from paying overtime and minimum wage to a particular employee if that employee meets (1) a salary test and (2) a duties test. Under the prior rules, the salary test was satisfied with a salary of as little as $155 per week. The new regulations raised the salary threshold requirement from $8,060 to $23,660 ($455 per week) per year. **Beginning on August 23, 2004, employees earning less than that amount cannot be considered exempt from wage/hour requirements**. According to the DOL, this change will extend overtime and minimum wage rights to 1.3 million low-wage workers who were denied these rights under the old rules.

Under the duties test, an employee needs to be an executive, administrative, professional, and/or highly compensated employee to qualify for wage/hour exemption. The revised rules retain most of the same criteria for determining whether an employee is exempt, with several notable changes.

Executive Employees. Under the revised rules, an employee must meet the following requirements to qualify for the "executive" employee exemption:

1. The employee's primary duty is the management of the organization or management of a department or subdivision of the organization;
2. The employee regularly directs the work of two or more other employees; *and*
3. The employee has the authority to hire or fire other employees, or the employee's suggestions as to hiring, firing, or promotion of other employees *are given particular weight* by the employer.

Under the duties test, an employee needs to be an executive, administrative, professional, and/or highly compensated employee to qualify for wage/hour exemption.

The new rule defines factors to consider in determining whether an employee's suggestions as to hiring, firing, or promotion are "given particular weight." Such factors include whether it is part of the employee's job duties to make such suggestions; the frequency with which such suggestions are made or requested; and the frequency with which such suggestions are relied upon by the employer.

Administrative Employees. Under the revised rules, an employee must meet the following requirements to qualify for the "administrative" employee exemption:

1. The employee's primary duty is the performance of non-manual or office work directly related to management or to the general business operations of the employer or its customers; and
2. The employee's primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

The revised regulations provide some additional guidance regarding what constitutes "work directly related to management or general business operations." They do not include the "position of responsibility" test or the "high level of skill or training" standard that the DOL had proposed. *(continued on page 3)*

Nonprofit Alert is published monthly by the Virginia law firm of Gammon & Grange, P.C.

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Professional Employees. Under the revised rules, for an employee to qualify for the "professional" employee exemption, the employee's primary duty must be performance of work that requires either:

1. Advanced knowledge (*i.e.*, work which is predominantly intellectual in character, and which includes work requiring the consistent exercise of discretion and judgment) in a field of science or learning acquired though a prolonged course of specialized instruction (*e.g.*, minister, lawyer, doctor, nurse); or

2. Invention, imagination, or originality in a recognized field of artistic or creative endeavor (as opposed to routine work), which includes fields such as music, writing, acting and the graphic arts.

The revised rule includes a new definition of "work requiring advanced knowledge" as "work which is predominantly intellectual in character, and which includes work requiring the consistent exercise of discretion and judgment." The revised rule does not make any changes to the educational requirements for the professional exemption.

Highly compensated employees. Under the new rules, employers may deny time and a half overtime pay to "highly compensated" employees who earn an annual salary of at least $100,000 and regularly perform one or more of the exempt duties and responsibilities of an executive, administrative, or professional employee. For purposes of determining whether an employee meets this $100,000 threshold, fringe benefits such as medical insurance and retirement plan contributions are not included in salary.

Safe harbor. Under the old rules, an employer's failure to pay an employee the proper overtime pay due could result in huge damage awards, including back overtime pay for up to three years, liquidated damages, interest, and attorneys' fees, even if the employer had a good faith belief that the employee was exempt. The new rules provide a more clearly defined "safe harbor" from certain damages for employers who act in good faith to correct an incorrect payment, and who do not willfully continue to withhold overtime pay.

➥The final FairPay regulations can be found on the DOL's web site, http://www.dol.gov/fairpay, which also includes resources for compliance assistance. The DOL is expected to zealously enforce these revised rules. As a result, prompt and proper classification of employees as exempt or non exempt is now a matter of high level risk management. If you are unsure of an employee's eligibility for a wage/hour exemption, or if you would like a general audit of your organization's policies, practices, and exempt/non-exempt job classifications to ensure compliance with the revised rules, contact Steve Clarke (smc@gg-law.com) or Steve King (shk@gg-law.com) at (703) 761-5000.

Nonprofit *Alert*®
8280 Greensboro Drive, 7th Floor, McLean, VA 22102-3807 • (703) 761-5000 Fax: (703) 761-5023 • E-mail: npa@gg-law.com
Editor-in-Chief . . . . . George R. Grange, II *Editor. . . . . Stephen M. Clarke*

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Liability & Risk Management

Former United Way CEO Sentenced

Oral Suer, former chief executive of the United Way of the National Capital Area ("UWNCA") in Washington, D.C., was recently given the maximum jail sentence—27 months–after pleading guilty to stealing $500,000 from the charity during his 27 years of employment. Mr. Suer admitted that he received excessive pension payments and unreimbursed cash advances, and that he charged UWNCA for fraudulent business expenses including bowling equipment and visits to see family members. The U.S. District Judge also ordered Mr. Suer to pay $497,000 in restitution for the thefts.

UWNCA officials contend that the $497,000 is far less than what Mr. Suer stole from the organization, and plan to seek repayment of another $1.4-million that Mr. Suer allegedly stole. These officials cite an audit, released in August 2003, which stated that Mr. Suer received $2.4-million more than his approved compensation and repaid less than half that amount to UWNCA. UWNCA has another pending lawsuit against Mr. Suer for repayment of $230,000 in excess pension payments.

UWNCA officials report that the organization has been severely damaged by Mr. Suer's actions. During the organization's 2003-4 fund-raising campaign, private donations shrank by more than half, to $38-million, down from the $90+ million that UWNCA raised in 2001. The organization formerly employed about 90 people, but now has only 35 employees. According to UWNCA officials, the organization is no longer able to run charitable campaign programs for federal employees as a result of the scandal.

➥**This scandal underscores the importance of (1) structuring a policy and practice of Board oversight of and accountability for executive officers; (2) establishing an independent audit committee that is informed by Sarbanes Oxley in its oversight of budget and financial practices; (3) utilizing the audit committee or establishing a compensation committee to document the organization's research of comparable compensation data and its exercise of due diligence in determining reasonable compensation for such officers; and (4) the implementation of accounting and fiduciary guidelines to minimize the risk of embezzlement or excessive payments. Our Nonprofit *Alert*® Memos, *Accounting and Fiduciary Guidelines for Nonprofits, Compensation Policies & Legal Guidelines for Nonprofit Leaders,* and *Annual Audits: Vital Risk Management* provide an overview of guidelines and policies that could help prevent such a scandal. See below for information on how to order these Memos.**

Summer Interns: Tips to Avoid Legal Traps

Summer brings a new crop of potential employees and volunteers, often high school or college interns, to many nonprofit organizations. Such interns can be a boon to employers, especially nonprofits, because they provide a welcome source of energetic manpower at low cost. But they can also be an expensive burden for the unwary. The tips below can help avoid some of the legal traps that complicate summer hiring:

Work Authorization and Reporting - If your organization plans to pay wages to an intern, the intern must provide proper work authorization, even if they have worked for your organization previously. They must complete and sign the standard I-9 form that all regular employees sign when starting work. You must report interns just as you would report any other new hires for state and federal employment reporting requirements under the Personal Responsibility Opportunity Work Act of 1996.

Income Tax Withholding - Most paid interns must complete and sign state and federal income tax withholding forms (*i.e.* W-4's) like all other employees. For these employees, the employer must account and withhold taxes in the same manner as for other employees. Most paid interns likely will not qualify for exemption from federal and state withholding laws; consult with legal counsel if you are unsure of whether an applicable exemption applies.

Wage-Hour Laws–Federal and state wage/hour laws, including overtime and minimum wage rules, likely will apply to a summer intern, even a part-time intern, unless that intern meets *all* of the following six criteria (or if the employer meets the "seasonal nonprofit employer test" that covers many seasonal employees of camps or conference centers).

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1. The work performed is an extension of a trade studied by the intern.
2. The work experience benefits the intern (*e.g.*, through college credit), not the employer.
3. The intern does not replace or displace regular employees.
4. The employer gains no "immediate advantage" from the intern's work (*e.g.*, billing clients for student's work).
5. The employer holds out no promise of future employment.
6. The intern is aware that he or she will not be compensated or entitled to wages for the work performed during the internship (this should be agreed to in writing by the intern before beginning work).

Child Labor Laws - Under most state laws, from June 1 until Labor Day, children aged 14 and 15 are legally allowed to work up to eight hours a day, for 40 hours per week, but they cannot work later than 9 p.m. Their jobs must be "age appropriate," and they must not be placed in any hazardous occupations or conditions. For instance, children are not allowed to operate heavy machinery under most state laws.

Hiring Dependents - If you hire children of your own or of other staff members, be sure that their wages do not exceed what other similarly situated and qualified employees are earning. This will help ensure fairness, maintain employee morale, and hopefully avoid IRS scrutiny over excessive compensation or private benefit.

If your organization plans to pay wages to an intern, the intern must provide proper work authorization, even if they have worked for your organization previously.

Written Terms of Internship; Oversight – To help ensure your summer interns' success, upon their arrival, run through a written checklist with them to review their work plan, duties and expectations, and hours of the position, schedule and train them as needed, and, very importantly and often overlooked, make sure their work is being properly supervised and that they are getting regular feedback on their job performance.

Volunteer Interns. While true volunteer interns are not generally subject to wage and hour or tax provisions, two cautions are noteworthy: (1) providing any material benefit such as free parking or meals, or a concluding bonus, can inadvertently convert the volunteer to employee status; and (2) all volunteers are agents of the entity with as much capacity to create liability through negligent conduct as an employee. Therefore, screening and training for volunteers should be virtually the same as for paid interns.

JOBS Act Limits Deductions of In-Kind Donations; Tightens 457(b)

While not yet law, the U.S. Senate recently passed legislation designed to curb inflated deductions for charitable donations of cars, intellectual property, and other non-cash property. These provisions, which are included in the Jumpstart Our Business Strength ("JOBS") Act (S. 1637), were introduced by the Senate Finance Committee Chair, Charles E. Grassley, R-Iowa.

The car donation provisions of the JOBS bill would limit a taxpayer's charitable deduction for a donated car to the amount for which the charity sells the car. The charity would be required to supply the auto donors with receipts from such sales. If the charity plans to use the car rather than sell it, the donor could take a deduction equal to the fair market value of the car.

The intellectual property provisions of the JOBS bill would allow an intellectual property donor to claim a charitable deduction equal to the lesser of five percent (5%) of the appraised market value of the donated property or $1 million.

Section 457(b) Plans

Another provision in the JOBS Act would impose stricter distribution, deferral election, and investment option requirements on nonqualified deferred compensation plans, including Section 457(b) plans, maintained by a tax exempt employer. For example, investment options in non-qualified plans would need to be comparable to the options in an employer's qualified retirement plan with the fewest investment options. Though technically applicable, these new requirements would not practically impact Section 457 plans that make funds in the plans subject to a substantial risk of forfeiture.

Since tax exempt employers began using Section 457(b) plans in 2002, they have become an increasingly important component of deferred compensation planning for such employers. A tax-exempt employer can maintain such a plan for a select group of its employees, and those employees can contribute up to the maximum elective deferral limit to either a Section 403(b) or 401(k) plan, and also to a 457(b) plan — $13,000 to each in 2004. For more information on the establishment of and legal restrictions that apply to these plans, call Gammon & Grange's co-counsel and ERISA expert Danny Miller, of Conner & Winters, at (202) 887-5711.

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Similar legislative provisions that would impose new requirements on Section 457 plans and limit charitable deductions of in-kind donations have been introduced in the House. The House will probably vote on this legislation in June, with a joint House/Senate conference to follow. Insiders think that some or all of the JOBS bill has a good chance of passing both the Senate and House this year, perhaps even before Congress leaves for its August recess. Stay tuned for updates on this important legislation.

Religious Broadcasters Suffer Sting of FCC Point System Approval

A recent decision by the U.S. Court of Appeals for the D.C. Circuit may make it more difficult for large religious broadcasting networks to obtain TV and FM radio noncommercial educational broadcasting licenses when competing with non-religious license applicants. *(continued on page 7)*

In this case, American Family Association ("AFA") challenged the FCC's point system on grounds that the system violated both statutory and constitutional provisions. Under the point system, which was created by the FCC 4 years ago to replace the comparative hearing process, competing applicants for TV or FM radio licenses with the most points are awarded a license. Points are awarded for local diversity of ownership, technical merit, established local entities, and for status as a "state-wide educational network," among other criteria. AFA argued that certain ownership preferences in the point system discriminate against religious broadcasting networks. The court, however, declined to review the parties' petitions, and upheld the point system. As a result of this ruling, it is expected that more than 50 pending religious license applications, including many applications that are in competition with applications of "state-wide educational networks," will be denied.

In its decision, the court acknowledged that "affiliates of some nonreligious organizations, like the NPR and PBS networks, are more likely to get licenses than the religious affiliates of centralized organizations like AFA." The court held that the FCC's decision to promote diversity and decentralization met the rational basis test. Thus, the court failed to intervene in the matter.

Although the court upheld the constitutionality of the point system on its face, it stated that any religious broadcaster denied a license by the FCC may challenge the denial on the basis that the point system, as specifically applied, discriminated against the broadcaster on the basis of religion. The court also noted that "[i]f AFA were to free its affiliates from its control, those affiliates could more easily compete with NPR's and PBS's affiliates under the system." *American Family Association, Inc. v. FCC & USA*, No. 00-1310, (D.C. Cir., May 11, 2004)

New & Improved Nonprofit *Alert®*

In response to our latest reader survey conducted last month, and to more effectively reflect our law firm's diverse strengths and practice areas, the Nonprofit ***Alert®*** will be undergoing several changes in the coming months. First, we will be distributing the ***Alert®*** for free beginning with this issue, which will be circulated in August, 2004. Because the ***Alert®*** will be free, you will no longer need a password to access it. Instead, we will be emailing it directly to your inbox in pdf format, and encourage you to forward it to to others. We will be publishing the ***Alert®*** bi-monthly, rather than monthly, which will allow us expand coverage and depth to our stories. Also, we will be expanding the scope of the content covered in the ***Alert®***. While continuing to focus on key legal developments in the nonprofit, tax exempt world, we plan to report more on developments in business law, intellectual property law, communications law, and wills and estates, which reflect our firm's practice areas. Accordingly, in choosing stories for the ***Alert®*** we will draw increasingly from our own experiences in helping clients manage risks and avoid liabilities. We appreciate and welcome your continued feedback and input.

To Order Memos: Memos referenced in the Nonprofit Alert can be purchased for $20 each ($10 for clients) from Gammon & Grange, P.C. Five or more copies of the same memo are bulk priced at $5 each. Visit the **Nonprofit Alert Memo Page** for details.

To Subscribe: Starting in June 2004, the NPA will be free with no login or password required. Visit the **Nonprofit Alert Page** to view current and past issues.