



Nonprofit Alert®

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

1. Nonprofit Overview

1.1 Charitable Giving, Nonprofit Employees Stand to Benefit From Pending Legislation. Two bills designed to spur charitable giving are back on the legislative agenda, and a third to benefit nonprofit employees will soon be introduced:

The first measure, H.R. 2499, would provide charitable deductions for millions of taxpayers who do not currently itemize their tax returns. It would enable them to take a 50% deduction for contributions totaling \$500 or more in a single year. For instance, a non-itemizing taxpayer who donated \$1,000 in a single year could deduct \$250 (i.e. 50% of \$500).

▶ Another bill, H.R. 2821, would permit individuals to roll over assets from their IRA accounts to charity without paying any taxes on the amounts. Current law permits taxpayers to withdraw funds at age 59½ without penalty, but they must pay income taxes on withdrawals even if they donate the funds to charity. This bill would encourage charitable giving from IRA accounts by removing the current tax burden.

▶ The third bill, known as the Retirement Account Portability Act, would allow workers to move their retirement benefits between different varieties of defined contribution plans. Thus, a nonprofit employee with a 403(b) plan could move to a private sector job and roll over his or her 403(b) to a 457 plan. Or if the same worker moved to a government job, he or she could roll over to a government plan without most of the current red tape.

★ **The first two measures could produce new donations for charities, while the retirement bill would give nonprofit employees more career and retirement options . Of the three, the deductions bill stands a better chance of passing this term. It has strong support with over 50 bipartisan sponsors.**

1.2 Work-Study Students Freed of Social Security Taxes. In a surprising reversal of its previous stance, the IRS now says graduate or undergraduate students who work for a nonprofit educational institution, where they are enrolled at least half-time in the final stages of their course curriculum, do not have to pay Social Security taxes. This relieves colleges and educational institutions of withholding and reporting requirements for those students. The IRS had

This Month . . .

- ★ Title Means Nothing for Payroll Liability...¶2.2
- ★ IRS Allows E-Mail Proof of Expenses..... ¶3.1
- ★ Work Program Clients Are Employees.....¶3.2
- ★ Gifting a Ghost Town¶6.2

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previously maintained that only students who take at least 12 credit hours and work not more than 20 hours per week are exempt from the tax. The IRS published that position in 1993 as a “Technical Advice Memorandum” directed only at Oakland University in Michigan, but IRS agents promptly began using it as guidance for college and university audits nationwide. The IRS finally changed its position after an intensive lobbying effort led by a coalition of 30 universities to broaden the exemption. The exemption does not apply to “career employees,” such as faculty or staff who take part-time classes for professional development. Employment that is not incident to and for the purpose of pursuing a course of study does not qualify for the exemption. IRS Rev. Proc. 98-16.

★ **This ruling may permit significant tax refunds for institutions that have been withholding in accordance with the IRS’s old rule. The rule also states that students working at other institutions, such as secondary schools, may also be eligible, but that will depend on the facts and circumstances of each case.**



Call the attorneys at Gammon & Grange if you think your organization qualifies for these refunds.

2. Liability & Risk Management

2.1 Cash Award Permitted; Not An Excess Benefit. The IRS has ruled that an annual cash award given by a foundation for the support of science and technology research does not constitute an excess benefit transaction under the intermediate sanction law because no one with a personal or private interest in the foundation’s activities was eligible to receive the award.

 **Although such awards raise private inurement or excess benefit concerns, this foundation appropriately linked the award to its exempt purposes and limited it with objective selection criteria. Before implementing an awards program, review NP9608-1, *Avoiding the Snares of Intermediate Sanctions*. See back page to order.**

2.2 *Company V.P. Narrowly Escapes Back Tax Liability.*

Despite their high-ranking positions, two corporate executives avoided liability for back taxes owed by their company because neither individual had any real authority to control corporate funds. One served as vice president, the other as secretary; but it was the president who actually controlled the company's finances. Under the "responsible person" theory, corporate officers like presidents, vice presidents, and treasurers can be personally liable for a corporation's unpaid payroll taxes. In this case, both individuals sold all their corporate stock and resigned shortly after learning about the president's illegal financing schemes. *Michaud v U.S.*, 92-822T (Ct.Fed.Cl. 11/26/97).

★ **Liability as a "responsible person" attaches to anyone exercising "significant control" in an organization. Although this case involved a corporation, the tax code makes no distinction in this area of liability between nonprofit and for profit organizations. Employees and volunteers who exercise "significant control" in your organization should understand their personal liability for unpaid payroll taxes.**

2.3 *Nonprofit Locked in Legal Battle With Its State Affiliate.*

The American Diabetes Association has sued its Rhode Island affiliate for splitting from the national association and taking its list of local donors, plus more than \$300,000 in contributions. The national association voted last year to merge all its state affiliates to eliminate management duplications, but the Rhode Island group refused to transfer its assets because it feared the national group would eliminate some of its state programs, such as a summer camp for diabetic kids. The legal trouble began when officials at the national association instructed the Post Office to re-direct all the state affiliate's mail to the association. The Rhode Island group reacted by obtaining a restraining order that stopped the national association's postal interference. The association then filed a federal suit, claiming the state group must forfeit its assets to the national association for breach of contract.

3. Employees & Volunteers

3.1 *IRS Now Accepts E-Mail To Document Travel Expenses.*

The IRS just made it easier to document and substantiate business

travel—a recent letter ruling approved the use of e-mailed or faxed travel itineraries to document business travel expenses when no airline tickets are issued. Information to establish the amount, date, place, and purpose of expenses is required for employees to claim a deduction for unreimbursed travel expenses or for employers to claim travel costs as legitimate business expenses. The case involved corporate employees who received itineraries from a travel agency via e-mail or fax in lieu of paper airline tickets. The tax code says documentary evidence such as receipts, airline tickets, and hotel bills can be used, but this IRS ruling expands documentary evidence to include electronic records. IRS LTR 9805007.

★ **As e-mail becomes the norm for business communications, the tax code lags behind with its reliance on paper. This ruling suggests how the IRS may embrace electronic communications to provide taxpayers more flexibility. If e-mail can adequately document business travel expenses for tax purposes, then why not e-mail donor receipts to substantiate charitable contributions?**

 **Tips for documenting and reimbursing travel expenses and other business expenses are outlined in NP9103-3, *Expense Reimbursement for Volunteers and Employees*. See back page to order.**

3.2 *Clients of Exempt Work Program Classify as Employees.*

A nonprofit rehabilitation facility operates three training programs for disabled clients, but the IRS says one program actually constitutes an employment arrangement because the facility exercises employer-like control over the clients. This makes the clients employees of the facility, despite the program's charitable purpose of preparing clients for formal employment relationships. Clients in the other two training programs were not employees because the facility didn't operate as much control over their work. IRS TAM 9801003.

★ **This ruling continues the volatile history of trying to define the line between bona fide charitable work rehabilitation for the homeless and others who are unemployable, and the taxable services of an employer using entry-level labor. Some clarity comes out of this ruling, but more battles will likely follow.**

4. Tax-Exempt News & Issues

4.1 *IRS Barks Up the Wrong Tree on Kennel Club's Income.*

Funds that a kennel club received from the broadcasting rights for its annual show are not taxable as unrelated business income, the IRS has ruled. Corporate sponsorship payments the club received from a pet food supplier also escaped UBIT. The club's main activity is holding its annual show, which accounts for its primary income and expenses. Unpaid volunteers organize and conduct the show, but the club sells broadcasting rights to a commercial network. Additional funds come from a pet food supplier, which sponsors the show and receives various benefits in return, including ad space, logo displays, and seats at the show. The IRS said the sale of broadcast rights serves the kennel club's same social welfare purposes by making club activities available to a far wider audience than they would otherwise reach. As such, income from the sale does not constitute UBIT. Sponsorship income from the pet

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food supplier is more “in the nature of an acknowledgment rather than advertising,” the IRS said; therefore, it is not subject to UBIT. IRS LTR 9805001.

4.2 Inflation Raises Amounts Donors Deduct For Quid Pro Quo.

The IRS has released new values for determining when donors can disregard certain benefits that they receive in exchange for charitable contributions (i.e. quid pro quo). Donors may deduct their full contributions of \$35.50 (up from \$34.90 in 1997) or more if the only benefit they receive costs \$7.10 or less (up from \$6.90 in 1997). The IRS considers any benefit of \$7.10 or less insubstantial. Donors may also deduct full contributions if the only benefits they receive have a market value equal to no more than 2% of their contribution or \$71, whichever is less (up from \$69 in 1997). IRS Rev. Proc. 97-57.



Charities rely on these figures when receipting contributions. A discussion of these rules, plus other safe harbor provisions, is included in NP9505-1, *Demistifying the Receipting of Charitable Gifts*.

5.1 Florida Privacy Proposal Defeated; Mailing Lists Now Safe. The Florida Constitutional Revisions Commission voted not to recommend a proposed amendment to the state constitution that would have prohibited the sale or rental of mailing lists.

★ **As Nonprofit Alert reported last month, this proposal grabbed the attention of many state regulators searching for ways to curtail the proliferation of mailing list transfers. Although the effort failed in Florida, officials in Colorado are considering a similar amendment.**

5.2 Connecticut Protects Charities From FOIA Requests. A domestic crisis center that received more than half its budget from government sources does not have to comply with the Freedom of Information Act (FOIA), a state appeals court ruled. The act applies only to government agencies. Regardless of its significant government financing, the crisis center was not a government agency, the court ruled. The issue arose when a former employee sought access to the center’s records. The state’s FOIA Commission granted access, but the appeals court overruled.

5. State Rules & Regulations

NPA Highlight of the Month

Employees on Loan: Are You Their Employer?

Suppose your organization relies on several temporary (or permanent) employees from a staffing agency. The staffing agency, applying its own rules, terminates the employee, after consultation with you, because of poor performance. If the former employee sues, your nonprofit has no worry, right? Wrong! Under the “joint employer” doctrine, your organization could be liable along with the staffing agency. This also applies to employees on loan or “borrowed” from another organization, whether they’re considered temporary or not. Consider this case: seven court clerks brought sexual discrimination claims against a judge, the court that employed the judge, and the county where the court was located. The county was initially dismissed from the case because it was not the “employer,” since state law specified that the judge and clerks were hired by the court. But on appeal, the county was held liable with the court as a “joint employer” because it controlled the clerk’s daily work, funded their salaries, regularly evaluated their performance, provided counseling when the clerks complained of harassment, and initiated the investigation of the judge. Thus, the issue depends on the nature of the employment relationship between *all* the parties, not merely the party known technically as the “employer.” *Graves v. Lowery*, 117 F.3d 723 (3rd Cir. 1997).

★ **This means your organization may be susceptible to discrimination complaints brought by temporary “leased” or “borrowed” employees, as well as your regular employees. As the practice of staffing nonprofits through outsourcing grows, so do the legal challenges. Assume, for instance, you rely on a consultant loaned temporarily to your organization from another nonprofit. You control all the consultant’s daily work activities, and indirectly fund the consultant’s salary through a reimbursement to the other nonprofit. Depending on the degree of control you exercise over the consultant’s work, your organization may be considered the consultant’s “joint employer,” subject to liability for any discrimination complaints he or she files. How you pay the consultant is a secondary issue. Recent guidelines released by the EEOC also say that such temporary employees must be counted when determining whether an employer has the requisite number of employees for coverage under federal discrimination laws (generally, 15 or more employees). The guidelines make joint employers jointly and severally liable, which gives employees the option of going after either or both employers in a “joint employer” situation.**



If your organization currently relies or plans future reliance on temporary “leased” or “borrowed” employees, consult legal counsel to perform a focused human resources audit prior to signing a contract with the staffing agency, so your liability risks can be reduced. For a complete outline of all federal laws prohibiting discrimination in the workplace, review NP9312-1, *Avoiding Employment Discrimination in the Nonprofit Organization*. See back page to order.

6. Gifts & Fund Raising

6.1 Bookstore Launches Creative Fund Raising Venture.

Barnes & Noble, an upscale bookstore chain, just introduced an on-line fund raising venture for charities willing to feature books on their web sites. Links from the charity sites go to the Barnes & Noble site, where visitors can purchase the featured book. Barnes & Noble then donates 5% to 7% of the purchase price to the charity. Barnes & Noble operates a special site for participating charities that shows how much money they're raising and which featured books are selling best. Charities select which books they feature and may change selections at any time.

★ However creative this fundraiser may be, a few precautions are in order: First, be careful of fundraisers that aren't related in some way to your charitable mission; they could trigger UBI taxes. Second, nonprofits entering joint ventures with commercial companies must not sacrifice any degree of control over their operations or assets (see "Highlight of the Month," *NPA* Feb. '98). And always get legal advice before taking action.



For more information about the Barnes & Noble program, call (212) 352-3630 or visit their web site at: www.barnesandnoble.com.



Find details about UBIT and joint ventures in these respective Nonprofit Alert Memos: NP9110-1, *A UBIT Primer for Nonprofits*; and NP9304-1, *Organizing the Nonprofit and Its Subsidiaries*.

6.2 Gifted Ghost Town Scares Up Tax Deduction. In the strange but true category, a wealthy rancher/real estate developer has donated a 120-acre Arizona ghost town to the Salvation Army. The property was once a thriving mining town called Sasco, but after the mines went bust, the town crumbled. Located about 35 miles north of Tucson, the property is valued at \$1.2 million. Although this marks the first ghost town the Salvation Army has ever received, officials say they hope to sell the property to someone who might see it as a tourist attraction.



Maybe your planned gift department hasn't anticipated a ghost town, but is it equipped to handle donations of real property? Find out how to manage the unique risks associated with gifts of property by reviewing NP9109-6, *Gifts of Property*. See ordering instructions in the box at right.

7. Executive Items of Interest

7.1 Quote of the Month. "...THE REAL PROBLEM WITH REFORM IS THAT NOBODY REALLY KNOWS WHAT TO DO...TAX-EXEMPT ORGANIZATIONS ARE SO PREVALENT, INFLUENTIAL, AND VOCAL THAT THE PROSPECT OF DECIDING WHO NEEDS REFORM—AND HOW—IS DAUNTING." — Former U.S. Rep. J.J. Pickle (D-TX), writing in his autobiography, *Jake*. Pickle retired in 1995 as chairman of the House Ways and Means Oversight Subcommittee after a long battle for tax reform, which eventually led, in part, to enactment of the intermediate sanctions that now apply to tax-exempt organizations.

7.2 Electronic Newsletter Published for Board Members. The Center for Nonprofit Management and the Volunteer Consulting Group have debuted a new electronic newsletter for trustees and board members. The newsletter features tips for improving board performance and suggestions for conducting efficient board meetings. The publication appears monthly and is offered free of charge.



For information, contact the Support Center by phone, (415) 541-9000, fax (415) 541-7708, or e-mail: supportcenter@supportcenter.org. The newsletter is available via fax or e-mail, but you must specify one or the other.

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