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Nonprofit *Alert*®

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

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NPA Special Insert on

Charitable Solicitation: What to Know Before Raising Funds

Congress Resurrects Charity Tax Bill

The White House announced compromise legislation last month resurrecting certain charitable tax breaks and funding programs that had been previously tabled.

The bill does not include the "charitable choice" provisions of a measure the House passed last fall, although it contains many other similarities. It also builds on the President's widely reported faith-based initiatives.

Non-Itemizer Benefit

The bill's authors, Sens. Joe Lieberman (D-CT) and Rick Santorum (R-PA), say it is designed primarily to encourage charitable giving. It's centerpiece is a provision allowing individuals who don't itemize on their tax returns to claim at least some of their charitable deductions—a tax break previously available only to taxpayers who itemized.

The bill would allow an "above the line" deduction of $400 for single non-itemizers and $800 for married couples who don't itemize. It would expire in 2003, unless Congress acts at a later date to extend it.

According to the trade association Independent Sector, the provision would benefit some 86 million taxpayers who don't currently itemize. Taxpayers who receive deductions for charitable donations tend to give substantially more, according to research by Independent Sector. This measure capitalizes on that behavior.

Other Tax Incentives

Other key provisions include:

- IRA Charitable Gifts - permits direct gifts to charity, or rollovers to charitable remainder trusts, pooled income funds, and charitable gift annuities from IRAs after age 67.
- Corporate Gifts - raises the taxable income limit on corporate gifts to charity from the present level of 10% to 13% in 2002 and 15% in 2003.
- Gifts of Food - makes all businesses eligible for the deduction for gifts of food inventory, currently available only to "C" corporations.
- Foundation Income - reduces the excise tax on foundation investment income from 2% to 1%.

Faith-Based Provisions

The bill also contains a narrowly-tailored "equal treatment" section addressing problems that faith-based social service providers encounter with government funding. Specifically, the bill says a faith-based provider may not be disqualified from government funding merely because the provider=s name or charter contains religious language or because its facilities contain religious art, icons or other religious symbols.

It does not, however, address religious hiring preferences—an issue of concern with earlier "charitable choice" proposals.

Earlier "charitable choice" legislation, including H.R. 7 which passed by the House last summer, contained comparable or more extensive protections, but they would've applied only to specific programs covered by "charitable choice" legislation. The new legislation's protections apply more broadly to "any social service program."

This section also authorizes organizations that receive government funding to subcontract with faith-based groups. It does not, however, address religious hiring preferences—an issue of concern with earlier "charitable choice" proposals. It remains to be seen whether amendments will be attached that protect or restrict the rights of religious entities in making employment decisions based on religious grounds.

Outlook

Known as the Charity Aid, Relief, and Empowerment Act (CARE Act), the bill is receiving widespread bipartisan support. After the 9/11 crisis when similar measures were put on hold, many charity leaders did not

(continued on p. 4)

Liability & Risk Management

Spam Email Is Trespass; No Free Speech Concern

A California appellate court has enforced an injunction against a former Intel employee, preventing him from sending unwanted email across the company=s proprietary communications system. The injunction doesn=t violate the employee=s free speech rights, the court said, because his unauthorized use of Intel=s communications system constituted a Acommon law trespass to chattels@ (i.e. property). Using the confidential email addresses of at least 35,000 Intel workers, the employee repeatedly sent messages deriding Intel=s employment policies. Intel ordered him to stop, but he evaded security measures and hacked into the company=s system again. Some 450 employees replied to the unwanted messages and asked to be removed from the mailing list. Intel claimed he disrupted business and caused significant losses in productivity as employees dealt with unwanted email. Because Intel=s communications system was Anot freely and openly accessible to the public,@ the court said the system and the confidential employee addresses included in it actually constituted Intel property in which the former employee could have no free speech rights. *Intel Corp. v. Hamidi,* 114 Cal.Rptr.2d 244 (Ct.App. 2001).

Studies show employees often spend up to an hour per shift sorting and deleting spam email. Experts predict email volume will grow by 45% this year. To counter this trend, employers must be proactive in defining appropriate email -use policies. Gammon & Grange offers a checklist identifying key elements in a prudent email policy. For a free copy, contact Jo-Anne Kehmna at jak@gandglaw.com.

Suspect Transaction Falls Short of Self-Dealing

The numbers just didn't add up—and that was good news for a Texas businessman who overcame charges of self-dealing, after the Tax Court determined that property he transferred to a private foundation wasn't enough to make him a "substantial contributor." For many years, the businessman conducted deals with an attorney who also served as trustee of a private foundation. When the businessman fell on hard times, the trustee proposed that the foundation purchase the businessman's home, valued at $535,000. The foundation agreed to pay $375,000 and granted the businessman rent-free living in the home for three years. The businessman was later convicted of tax evasion, and the trustee began eviction proceedings after he refused to vacate when his three year rental term expired. The businessman's wife then filed for bankruptcy, claiming the sale to the foundation was invalid because her husband held no interest in the house. The bankruptcy court determined the sale was valid, however, which paved the way for additional charges against the businessman. Based on the bankruptcy court's ruling, the IRS said the property had been sold at a "bargain" price, resulting in a contribution to the foundation, which made the businessman a substantialcontributor subject to the self-dealing penalties. But the Tax Court didn't agree. The court said a donor can be "a substantial contributor only if the transfer to the foundation exceeds...two percent of the total contributions received by the foundation." In this case, the total price paid for the house, plus the fair market value of three years' free rent, totaled $493,276. That left a charitable transfer of $41,724 to the foundation from the businessman, which fell nearly $6,000 short of the two percent minimum, the Tax Court concluded. This meant the businessman couldn't be considered a "substantial contributor" and, therefore, wasn't a "disqualified individual" subject to the self-dealing prohibitions. *Graham v. IRS,* T.C. Memo. 2002-24 (1/24/02).

Individuals, who are considered "disqualified persons" by virtue of their association with a foundation, must be very careful to avoid prohibited transactions—and the significant taxes and penalties that can result. As this case demonstrates, even substantial contributors face scrutiny if the numbers add up. Note that if the businessman had served on the foundation's board, this almost certainly would have been a prohibited transaction.

Copyright Filings Experience Mail Delays

If you've recently filed for copyrights or mailed anything to the U.S. Copyright Office (USCO) in Washington D.C., please note: the USCO has suspended mail **indefinitely** due to the threat of anthrax in government buildings.

The USCO is currently receiving only hand-delivered filings and other documents. While the USCO will take mail delays into account for deadlines, it urges applicants to send copies via a private or commercial carrier. This can inject uncertainty into the filing process, so it's best to check with competent counsel to ensure that filing deadlines are met.

Employees & Volunteers

Loose Lips Sink Ships . . . And Employee Lawsuits

An employee can't claim his rights were violated when medical information was disclosed to a potential employer after he freely shared the same information with co-workers, a federal court has ruled. A trucking company kept drivers' medical records in a confidential file, accessible only by a manager and an administrative assistant. However, one driver often told co-workers about his medical problems and shared stories about workers compensation. The driver applied for a job

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workers compensation. The driver applied for a job at another trucking company, and listed a co-owner as a reference, but allegedly misrepresented his medical status on his job application. After he was hired, the new company contacted the co-worker, who casually mentioned the driver's medical condition. The driver then admitted he'd given false information on his application and was fired from his new job. He filed an EEOC complaint against his old company, alleging that disclosure of his private medical records violated the Americans With Disabilities Act. But evidence presented at trial showed the driver's medical files were never accessed. Instead, all the information leading to his dismissal came from co-workers with whom he had shared medical information The court said the driver made his personal information common knowledge at his old job, thereby relieving his former employer of liability. The court said the driver implicitly consented to disclosure of such information when he gave as references the names of co-workers with whom he'd shared the information. *EEOC v. Overnight Transportation Company*, 2001 WL 1521584 (W.D.VA 11/30/01).

Don't mis-read this case: appropriately maintaining confidential records is essential! If those with access to the driver's medical files had disclosed information, or if the driver had not disclosed information voluntarily, the result in this case would likely have been different. Note, however, that the second employer's careful record checking and termination was based not on the driver's medical condition, but on false statements in his application.

Employee Manual Isn't Contractual During RIF

Statements about reductions in force (RIFs) found in an employee handbook are not incorporated into employment contracts when the handbook contains a valid disclaimer that removes them from contracts for purposes of employment disputes, the Second Circuit Court of Appeals has ruled. The case arose when four employees were terminated during a RIF. They brought suit, claiming their employee manual said RIFs would be applied according to seniority and performance, but the company didn't follow this criteria. The manual also said the employer could change policies "for reasons of economy and efficiency," and that nothing in the manual was to be construed as creating any rights or presumptions for employees. The Second Circuit said that language served as a clear disclaimer, sufficient to establish that no other understanding of the manual would be "objectively reasonable." Thus, the employer was not contractually obligated to take seniority or performance into account during the RIF, the court concluded. *Baron v. Port Authority of NY and NJ*, 271 F.3d 81 (2nd Cir. 2001).

The message for employers: make sure all manuals and policies contain clear disclaimers, and do so before confronting the need for employee actions. If your employee handbook doesn't already contain adequate disclaimers, consult legal counsel to consider proper revisions.

Tax-Exempt Issues

Nonprofit ISP Regains Exemption with Subsidiary

A nonprofit internet service provider (ISP) has regained its exempt status after breaking out all its profit-making, nonexempt operations into a separate taxable subsidiary. The ISP also changed its charter to limit its services. Originally established as a §501(c)(3), the ISP lost is exemption in 1998 when the IRS ruled that its primary activity did not further its exempt purpose of providing free or affordable Internet service to low income users. Its financial records showed that over 75% of its users were not low income and were actually paying user fees for the service. The IRS also noted that much of the ISP's activities were geared to promoting and marketing its Internet services. To correct the problems, the ISP established a subsidiary and transferred all nonexempt functions to it. Then, the ISP reorganized and amended its articles of incorporation to narrow its charitable mission specifically to "low-income persons and other §501(c)(3) organizations." The IRS accepted the changes, reinstated the ISP's exempt status, and even relieved the ISP of any unrelated business income taxes that might have applied during the years it carried on non-exempt activities. IRS TAM 200203069.

Here's an excellent example of what can be accomplished with subsidiaries. Through a well planned and executed reorganization, this ISP managed to save itself, plus all its exempt *and* non-exempt functions.

HUD Suspends Faith-Based Housing Program for Violations of PartnershipAgreement

Officials with the Department of Housing & Urban Development (HUD) suspended a partnership last month with the Church Association for Community Service in Washington, DC, that was to have renovated 300 abandoned houses for low-income families. The *Washington Post* reported that HUD claimed the association violated terms of the partnership when it hired a for-profit company to do the renovation and sale of the homes.

So far, 31 houses have been sold or are under contract at an average price of $141,000, which HUD says is nearly $40,000 more than what the renovations cost per house. HUD is reviewing the program to determine whether the association is capable of managing it further. The D.C. inspector general is also investigating whether the association improperly contributed charitable funds to political events.

➤**Because of the public debate currently focused on faith-based initiatives, religious organizations must be prepared for intense scrutiny if they stumble. Federal funds come with a cost: careful compliance with all regulations apply to religious and secular groups alike. Understand the implications with Nonprofit Alert® Memo**, *Charitable Choice & Faith-Based Initiatives*, **available from Gammon & Grange, P.C. Refer also to the Department of Health & Human Services' web site designed specifically for faith-based social service providers at http://www.hhs.gov/faith.**

If your organization conducts or plans to conduct activities that may not further an exempt purpose (especially any profit-making enterprises), consider spinning them into a subsidiary. Learn more with Nonprofit Alert® Memo, *Subsidiaries & Nonprofit*

School Avoids UBI Taxes on Golf Course Income

Income from a golf course operated by a tax-exempt school won't be taxable as unrelated business income because the golf course plays a major role in the school's rehabilitation and vocational training program, the IRS has ruled. The school serves court-referred juvenile offenders through a training program that uses the golf course as a teaching lab, incorporating students in nearly all aspects of its operation. A major purpose of the school's program teaches juveniles "pro-social skills" and career development. The school also offers a golf course maintenance course that provides hand-on instruction in a variety of areas including turf management and pro shop operations. The IRS said the golf course actually constituted a trade or business, as defined in the tax code, because it was open to the public and charged user fees at competitive rates. But because it was so critical to the successful execution of the school's vocational training program, the IRS ruled it was substantially related to the school's exempt purpose. The IRS identified several additional factors that distinguished the school's golf course from a commercial one:
(1) no professional golfers were hired on staff;
(2) no "golf instructional packages" were offered;
(3) there was little or no advertising; and
(4) all maintenance was performed by students.
Based on these facts, the IRS concluded the golf course furthered the school's exempt purpose and, therefore, did not generate income subject to taxes. IRS PLR 200151061.

The IRS often pursues organizations like schools and universities that operate golf courses because such facilities generate substantial incomes. Usually, they're ruled non-exempt and hit with UBIT, but this case demonstrates how the "relatedness" of an activity depends on the program's implementation and operation. Here, the golf course passed the "relatedness" test because it played such a critical role in the school's vocational training program for juvenile offenders.

Charity Tax Bill Resurrected ....*continued from p. 1*

expect Congress to reconsider these tax incentives anytime soon. But the economic downturn and decline in charitable giving brought renewed attention to the financial plight charities were facing, creating incentive for revival and expansion of these initiatives.

Read more about this legislation at Sen. Lieberman's web site, http://www.senate. gov/lieberman. The full bill is accessible at the Library of Congress, http://thomas.loc. gov.

Ordering Information: Memos referenced in the ***Nonprofit Alert*** can be purchased for $20 each ($10 for firm clients) from Gammon & Grange, P.C. Five or more copies of the same memo are bulk priced at $5 each. Call, write, or email us at the address below.
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Charitable Solicitation Registration: What You Need to Know Before Raising Funds

More than ever before, states are regulating fundraising by charitable organizations in an attempt to protect their residents from solicitation fraud. If your organization solicits contributions, you should be aware of the following:

Who Regulates Charitable Solicitation? Currently, the laws of all but a handful of states specifically regulate the solicitation of charitable contributions, and most states that regulate require charities to register before soliciting. In addition, many local governments have adopted their own solicitation regulations, creating a complex web of requirements for charities that solicit regionally or nationwide.

Exemptions From Registration Requirements. Most state charitable solicitation laws provide for exemption of specified entities from registration requirements. Exemptions vary by state, but may include religious entities; certain hospitals; libraries; educational institutions; public radio and television stations; political action committees; small organizations that do not annually raise more than a specified dollar amount; and organizations that solicit solely from members. In some states, a charitable exemption is lost if the organization contracts with a professional fundraiser.

A Note to Our Readers

With this issue, *Nonprofit Alert* introduces a new feature: one page inserts designed so you may conveniently save and file them for future reference. Topics address emerging issues of concern to nonprofits and offer in-dept analysis crucial to executive decision-making.

Got a topic you'd like to know more about? Let us hear from you: npa@gandglaw.com, or (703) 761-5000.

Religious Organizations. One of the most common exemptions from registration and reporting requirements applies to religious organizations. However, state definitions and interpretations of what qualifies as an exempt religious organization vary significantly. While some states exempt or exclude any entity organized for religious purposes, others exempt only churches or church-related entities.

Additional concerns for nonprofits to consider before undertaking charitable solicitation include the following:

- ***Internet Fundraising.*** Internet solicitation alone may trigger registration requirements in numerous states.
- ***Professional Fundraisers.*** Contracting with fundraising consultants and especially with professional fundraisers/solicitors often increases an organization's registration and reporting requirements.
- ***Disclosure Language.*** Many states mandate that specific disclosure language appear on all printed charitable solicitation materials, and that telephone solicitors make certain disclosures.
- ***Annual Reports and Filing Fees.*** Most states that require registration also mandate an annual filing of updated information, including a current IRS Form 990, audited financial statement, and copies of professional fundraising contracts. Filing fees for annual reports ranges up to several hundred dollars in some states.
- ***Penalties for Noncompliance.*** State laws generally provide that fines and injunctions may be imposed on organizations that have solicited when not registered, or have otherwise violated solicitation regulations.
- ***Unified Registration Form.*** The state registration process has been simplified somewhat in recent years as many states now permit use of a unified registration form adopted by a coalition of state charity regulators. However, several states still require a state-specific addendum to the unified form.

The professionals at Gammon & Grange routinely assist organizations with negotiating the maze of state fundraising regulation. We have streamlined the process of analyzing an organization's compliance requirements, including preparation and filing initial registrations, exemption requests, and annual reports. For more information, contact Steve King at (703) 761-5000.

Because requirements vary from state to state, your organization may be in full compliance in one state but not in another—an especially important point to remember if you're just beginning charitable solicitations or expanding into new states where you haven't previously solicited. Remember, "solicitation" in most states is defined as occurring wherever it is received by a potential donor, so a charity must be concerned about jurisdictions beyond its home state or locality, particularly where solicitations are done electronically. Charities should also check periodically to see if registration is now being required in a jurisdiction where none was required previously.