



Nonprofit *Alert*®

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

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Church Revocation Upheld, Despite IRS Delay

The Church Audit Procedures Act provides special protections and examination procedures for churches facing IRS audits, including a provision specifying that audits of churches must be concluded within two years after commencement.

But under a recent ruling from the Court of Appeals for the Federal Circuit, the IRS may revoke a church's tax exemption even if its examination exceeds the two year limit.

The case involved the Music Square Church, which underwent an IRS audit starting in December 1989. However, the IRS didn't issue a final determination letter until April 1996, revoking the church's tax exemption retroactive to 1989.

The IRS charged that the church was established for the sole purpose of willfully evading income taxes on behalf of the founder, rather than for an independent charitable mission.

The church objected to the IRS's revocation of its exempt status, citing the two year limit under the Church Audit Procedures Act. The IRS couldn't issue any orders after that time, the church argued, because it had exceeded the limitations under the tax code.

But the Court of Appeals disagreed. "Congress intended to convey benefits to churches in connection with their IRS affairs, and at the same time...[strike a bargain] in terms of churches' ability to convert IRS lapses into anti-enforcement swords," the court wrote.

The law allows aggrieved parties to seek a court-ordered stay of proceedings when the IRS abuses its authority. Other than that remedy, the church had

no recourse apart from the defenses available to ordinary taxpayers, the court said. *Music Square Church v. U.S.*, No. 99-5109 (Ct. App. Fed. Cir, 7/13/00).

➤ **For more details on these important protections for churches, read an informative summary of the law in Nonprofit Alert® Memo, Church Audit Procedures Act: Know Your Rights. See back page to order.**

Church Property at Foreclosure Risk if Withholding Taxes Not Paid

The Seventh Circuit Court of Appeals says the IRS may foreclose on church property to settle unpaid tax liabilities if a church fails to pay withholding taxes for its employees, even if the church believes that paying taxes violates its religious principles. The ruling settles a long-running dispute with the Indianapolis Baptist Temple, which hasn't paid employment taxes since 1987. The IRS claims the Temple owes \$3.5 million in back taxes, penalties, and interest, but the Temple argues it is protected by the First Amendment. *U.S. v. Indianapolis Baptist Temple*, No. 00-1102 (7th Cir., 8/14/00).

➤ **The court saw no First Amendment intrusion, concluding, "The normal incidents of collecting federal employment taxes simply do not involve the intrusive government participation in, supervision of, or inquiry into religious affairs that are necessary to find excessive entanglement. Even the somewhat more intrusive tax foreclosure ordered in this case is a discrete event involving no inquiry into religious matters."**

▶▶▶ Just Sign on the Dotted Line . . . or E-Sign ◀◀◀

The Electronic Signatures in Global and National Commerce Act became effective this month, making it legal for the first time to rely on electronic signatures via email or other digital media. The law offers a general prohibition against invalidating contracts merely because they're signed electronically but leaves the details up to the states. The law does not permit certain legal documents such as eviction notices or health insurance lapses to be transmitted electronically, however.

Liability & Risk Management

Cancer Official Pleads Guilty to \$7.8 Million Scam

In July, **Nonprofit Alert**® reported the FBI was investigating the disappearance of \$6.9 million from the American Cancer Society's Ohio division. Now, the organization's former chief administrative officer has pled guilty to embezzling funds totaling more than \$7.8 million. Daniel S. Wiant has admitted that he scammed the organization through bank fraud, money laundering, mail fraud, and the illegal use of credit cards dating back to 1997. Earlier this spring, the FBI discovered that he had wired money to an Austrian bank with instructions to distribute the funds as a research grant to a specified beneficiary, but the beneficiary and grants were both fictitious. Wiant fled to Europe, then allegedly called his wife to admit the embezzlement and tell her he was never coming home. Penalties carry up to a maximum of 30 years in prison and \$1 million in fines.

Fraud at this level is often avoidable through the adoption and implementation of sound fiduciary and accounting policies. For examples of such policies, order Nonprofit Alert® Memo, Accounting and Fiduciary Guidelines for Nonprofits. See back page for ordering instructions.

Injured In the Spirit: Ushers Not Liable for Fall

The Victory and Power Ministries Church of Baton Rouge, La. is not liable for the slip and fall injuries of one of its volunteer "greeters" during a Sunday morning worship service, a state appellate court has determined. The greeter was welcoming churchgoers during a "praise and worship" segment that preceded the regular morning service, when she was overcome by "the Spirit of the Holy Ghost, causing her to dance and shout in a spirit of praise," according to court documents. Before ushers could attend to her, she fell to the carpeted floor, injuring her arm and wrist. The ushers then helped her back into the pew with her husband and parents. She later sued the church, claiming the ushers had a duty to guard and guide her to prevent injuries during the worship service. The court rejected her claim, finding instead that the ushers did everything they could possibly do to prevent the accident. Being "overcome by the Spirit" was not anticipated by the ushers; therefore, their efforts to assist her after the fall was all that was legally required, the court said. *McGowan v. Victory and Power Ministries*, No. 99 CA 0235 (La. Ct.App. 2000).

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Nonprofit Alert is published monthly by the law firm of Gammon & Grange, P.C., which represents nonprofits nationwide. References in **Nonprofit Alert** in no way constitute an endorsement by **Nonprofit Alert** or by Gammon & Grange, P.C. **Nonprofit Alert** is distributed with the understanding that no legal, accounting or other professional services are rendered, and no attorney/client relationship is established. If legal advice or other expert assistance is required, the services of a professional should be obtained. ©1999 Gammon & Grange, P.C..

Assessing Board Performance: What to Do & Why

It's not uncommon for the board of directors to routinely assess an organization's chief executive. Some would even argue that such an exercise is the main function of a board. Data released by the Association of Governing Boards of Universities and Colleges, suggests that view is relatively universal among educational institutions where more than 80% of college boards evaluated their institution's presidents during the prior year. Surprisingly, less than half those boards conducted their own self assessments. So, who's evaluating the board? With greater government and donor attention now focused on accountability and responsibility, board self-assessments are prudent steps for any nonprofit organization to implement. A board may elect to hire an outside consultant to assist in the process, or adopt its own objective assessment plan based on the organization's mission and goals. As a minimum, any board assessment should address the following areas:

- stewardship and financial responsibilities;
- relationships with the CEO, staff, clients, and community;
- internal governing procedures and policies; and
- legal compliance and risk management.

Nonprofit Alert® Memo, Governing Responsibly by Nonprofit Board Members, can help map the perimeters of your board self-assessment. See back page to order.

Employees & Volunteers

Dress Down Days Blamed for Tardiness, Poor Habits


More than 70% of U.S. companies now support "dress down days" at least once a week, allowing employees to forego the usual coat and tie business attire in favor of more casual clothes. But a recent study suggests the causal dress code may be contributing to poor work habits. Forty-four percent of those surveyed reported an increase in absenteeism and tardiness after dress down days were instituted. Another 40% of managers said they felt workers were less productive on dress down days, and 30% reported a rise in flirtatious behavior. Still, 80% of those surveyed said that casual dress was one of their most well-received employee perks.

If dress down days contribute positively to employee morale in your organization, consider ways to curb the less desirable side effects. Communicate exactly what is permitted, including examples of acceptable and/or unacceptable attire for both men and women. Train and motivate employees to maintain high levels of professionalism, regardless of what they're wearing.

Disability Benefits Don't Prevent ADA Claim

An employee who receives Social Security disability benefits isn't necessarily barred from claiming discrimination under the Americans With Disabilities Act (ADA), the Fourth Circuit Court of Appeals has ruled. An employee with osteoarthritis worked in a textile mill without difficulty but was transferred to another mill that had concrete floors. Her doctor ordered her to wear support shoes and avoid working on concrete floors. When she requested a transfer, her boss told her the company did not operate mills with

anything other than concrete floors, which she knew to be untrue, given her experience in the first mill. She was then placed on involuntary leave and discharged four months later. Several months after that, her osteoarthritis worsened severely, and she applied for disability benefits. She told the Social Security Administration (SSA) that she could still work with an accommodation, but the SSA determined that she had been disabled as of two months after her discharge. The EEOC then sued the company for failing to accommodate her disability. The company defended by pointing to the employee's SSA application, which stated that she was unable to perform the essential functions of her job. If that were the case, the company argued, then she had no standing to sue under the ADA because there was no accommodation that would suffice. On appeal, the Fourth Circuit said the whole issue was simply one of timing. The date of the adverse employment action (i.e. when the employee was placed on involuntary leave) was the date to use in determining whether an accommodation was reasonable, the court ruled, not the date that the SSA granted her disability benefits, which was almost a year later. *EEOC v. Stowe-Pharr Mills, Inc.*, 2000 WL 779060 (4th Cir., 2000).

 **Recently updated Nonprofit Alert® Memo, ADA: Basic Requirements for Nonprofits, offers a layman's overview of this important employment law.**

Tax-Exempt Issues

IRS Paves the Way for Tax Exempt Highway Project


A private foundation's proposed grant to build a highway in a foreign country will satisfy the foundation's charitable purpose, the IRS has ruled, clearing the way for the project to proceed without any adverse tax consequences. The highway will run directly through much of the country and help improve the economic conditions of the country's citizens, most of whom live below the poverty level. Parts of the highway will be new construction, and other parts will be reconstruction of a transportation route already in existence. The highway will be assessable to the public free of charge for at least ten years from its completion date. The foundation had secured a promise from the foreign country's government that the grant would be used solely to fund the highway construction project, that any unused funds would be returned to the foundation, and that no part of the grant would be used to provide benefits to any disqualified individuals. These stipulations satisfied the IRS that the project was in furtherance of the foundation's charitable mission. IRS LTR 200031053.

NPA Highlight of the Month

Online Fundraising: States Propose Guidelines

They're affordable, easy, and effective. That's what many nonprofits say about online fundraising campaigns. Where the standard practices of mail, telemarketing, or door-to-door solicitations are time consuming, costly, and manpower intensive, online campaigns can reach hundreds more potential donors at only a fraction of the cost or manpower. But uncertainty has plagued the field as state charity regulators wondered how to impose compliance requirements for the burgeoning practice. Most states require charities to register and comply with various charitable solicitation regulations if they conduct fundraising or solicitations in the state, but applying those standards to online fundraising creates significant burdens for charities and regulators alike. Suppose a small, local charity included a fundraising appeal on its web site. Does that mean the charity should then register in every state merely because people all over the country could potentially view its web site?

The National Association of State Charity Officials says no. Last month, the group published a set of proposed guidelines that specify when a charity should or should not have to register with multiple states. The proposal would require a charity to register first in its home state and follow whatever charitable solicitation regulations are in existence there if the charity uses the Internet to raise funds. The charity would not have to register in any other state unless it: (1) specifically targets persons physically located in other states for solicitation; (2) receives contributions from donors in other states on a repeated and ongoing basis or in substantial amounts (exact amounts to be determined by the individual states); or (3) communicates by e-mail or other electronic means with residents outside its home state to request funds or promote its web site solicitations. The proposal says that a charity, which clearly represents on its web site that its fundraising efforts are purely local, would not be considered to "specifically target" citizens of other states, regardless of the wide accessibility of its web site. The association will accept public comments on the proposal, known as "The Charleston Principles," and will finalize the guidelines early next year. Each state will then determine if it will adopt the guidelines or develop its own policy regarding regulation of online fundraising.

 **To read the proposed guidelines in their entirety, go to the National Association of State Charity Officials' web site at <http://www.nasconet.org>. To evaluate the implications of charitable solicitation regulations on your organization, refer to Nonprofit Alert® Memo, *Charitable Solicitation Laws: A Multi-State Summary*. See back page for ordering instructions.**

Zoning Ordinance Upheld; Construction Continues

A U.S. district court has overturned a Maryland judge's ruling and upheld a local zoning ordinance that grants an exemption to religious schools. The judge had previously ruled that the ordinance was unconstitutional because it permitted religious schools to engage in construction projects without first securing a special exception from the county. The case arose when a Roman Catholic school began renovating and adding onto its building without seeking a zoning exception. The judge said the exemption relied upon by the school violated the Establishment Clause, and he issued an order enjoining the school from further construction. But the district court lifted his order and allowed the construction to continue, finding that the exemption was a permissible accommodation of religion. *Ehlers-Renzi v. Connelly School of the Holy Child, Inc.*, VLW 000-2-184 (8/14/00).

➔ **Last month, the Religious Land Use and Institutionalized Persons Act became the law of the land. This new federal law provides strong legal protections for religious organizations and individuals in zoning and prison settings, yet zoning laws still present special problems for nonprofits. Nonprofit Alert® Memo, Zoning & Land Use Issues for Religious Groups, addresses the legal points most helpful to know when facing zoning challenges. To order a copy, see instructions below.**

Three Is Better Than One: Transferring Control

The presidents of three related foundations wanted to centralize control and streamline their administrative functions to improve efficiency. All three foundations had similar philanthropic philosophies and goals. The presidents proposed to form a parent organization to retain control over all the foundations and appoint a majority of the trustees governing each individual foundation. The three foundations would fund the operation of the parent organization, and any money it receives would be considered grants. The IRS allowed this structure to be implemented, saying that it would not affect the exempt status of the three foundations or the parent organization. The funds granted from the foundations to the

parent would not be considered acts of self-dealing, the IRS ruled. The IRS even went one step further and said that any payments made by the foundations to a for-profit corporation owned by the presidents of the foundations would not be considered acts of self-dealing if the payments were based on market rates for comparable services. IRS LTR 200027055.

➔ **Although the facts of this restructuring are rather unique, the IRS's statements on self-dealing are instructive. For practical guidance on avoiding private inurement see Nonprofit Alert® Memo, Private Inurement: Do's & Don'ts. See back page to order.**

State Rules & Regs

California Limits Employment Arbitration Clauses

The California Supreme Court has sharply limited the provisions that arbitration clauses in employment contracts may cover. The clauses may still require employees to arbitrate their discrimination claims, but they must not limit the employee's right to recover full damages and attorney fees. The court also said the clauses must include provisions that allow for adequate discovery, a neutral arbitrator, written statements and conclusions, and limitations on the costs to employees. *Armendariz v. Foundation Psychcare Serv., Inc.*, 2000 WL 1201652 (Cal. S.Ct. 8/24/00).

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.

Subscription Information: Subscriptions to the *Nonprofit Alert* are \$75/year, \$130/two years. Additional subscriptions to the same organization are \$25 each/year. Subscriptions for 100 or more may qualify for additional bulk discounts. Send inquiries to: Editor, *Nonprofit Alert*, 8280 Greensboro Dr., 7th Floor, McLean, VA 22102-3807; (703) 761-5000; npa@gandglaw.com.

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October 2000

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