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Nonprofit Alert®

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

Inside This Issue:

H.R. 7 Update: Charity Legislation Stays on Track

The U.S. House of Representatives has passed legislation that amends rules governing private foundations and provides incentives for charitable giving. The Senate has already passed a companion bill, known as the Charity Aid, Recovery, and Empowerment (CARE) Act of 2003. The Senate and House must now reconcile the language in these two bills before submitting the final legislation to the President.

> One of the most comprehensive pieces of legislation to affect charities in recent years...

Charitable Incentives

The bill includes several incentives aimed at increasing charitable giving, which are similar to provisions contained in the Senate's CARE Act. Key among these incentives is an above-the-line tax deduction for charitable cash contributions in excess of $250 for individuals or $500 for joint filers who do not itemize their tax returns.

The maximum allowable deduction in any one tax year would be $250 single/$500 joint filers, but the deduction would be available only for tax years 2004 and 2005. An estimated 70% of all tax filers do not itemize, so this measure could potentially affect millions of taxpayers.

Another provision would allow tax-free distributions from IRAs for individuals age 70½ and over, so long as the distributions are made for charitable purposes. The provision would apply to direct gifts and split-interest gifts. Additional incentives target corporate giving, including an increase in the cap on corporate charitable contributions from 10% to 20% phased in over the next seven years, and an extension of the enhanced tax deductions for food inventory contributions.

Private Foundations

Previous versions of the legislation prohibited administrative expenses, such as rent and salaries, from being included in the percentage of charitable grantmaking payouts that private foundations are required to make annually (5% of a foundation's net assets).

The revised bill softens this prohibition, excluding only administrative expenses "other than those directly attributable to direct charitable activities, grant selection activities, grant monitoring and administration, and compliance with state, federal or local law." The bill also includes a provision that would reduce the excise tax that private foundations are required to pay on net investment income to 1% annually.

The bill specifies three additional categories of excluded expenses: (1) compensation paid to a disqualified person in excess of $100,000 annually, (2) air travel other than a regularly scheduled commercial flight, and (3) air travel in excess of coach accommodations.

The legislation also increases the initial excise tax on self-dealing from 5% to 25%. Both these provisions are intended to curb excessive trustee salaries and travel expenses reported at some large foundations.

(continued on p. 4)

Liability & Risk Management

Halloween Hayride Harm: Scary Scenario Case Proceeds Against Church

A volunteer's negligence claims against a church may proceed, says the North Carolina Court of Appeals, despite the church's claim of charitable immunity. Millette Clontz volunteered at the annual Halloween festival sponsored by St. Mark's Evangelical Lutheran Church. Her job was to stand in the woods and make scary noises as the hay wagon passed.

During the last ride, she walked beside the wagon, but when she stepped up to assist a child on the edge, she became caught on the wagon and was dragged for some distance. She sustained permanent injuries and later brought suit against the church for negligently overloading and improperly lighting the wagon. She also claimed the church failed to properly supervise the children.

As evidence, she presented facts showing the children engaged in "a lot of loud screaming and horsing around." Clontz showed that the light was insufficient to cover the entire trailer bed, which prevented proper visibility and supervision by the adults present.

The church argued for dismissal, but because the church had organized the hayride, determined how many passengers were allowed and what safety precautions should be taken, the court said it would be premature to dismiss the church.

The church then argued it was immune under the state's charitable immunity statute. But the court said the state law only applies in cases where a charity lacks liability insurance. In this case, the church did not show it actually lacked insurance; therefore, the court said it couldn't argue for immunity. *Clontz v. St. Mark's Evangelical Lutheran Church*, No. 02-606 (NC Ct. of App., 4/15/03).

If your organization is plans high risk activities, properly instruct employees or volunteers, then supervise during the event so their duties are carried out properly. If the event involves children, senior citizens, or others who need special care, make sure your insurance policy covers these additional risks.

Take whatever all necessary steps to qualify your organization, employees and/or volunteers for full or partial immunity under state law (e.g., carry sufficient liability insurance). Visit our web site (www.gg-law.com) for a 12-part safety checklist to help minimize these risks.

$1.25 Million Claim Dismissed; Foundation Cleared

In a case that presented novel legal questions about the grantmaking obligation of foundations, a U.S. district court ruled that a foundation has no contractual liability to 300 volunteers in Washington state who claim the foundation owes them $1.25 million.

Grant planning process was purely "exploratory" and not contractually binding .

The volunteers sued the Northwest Area Foundation earlier this year (*NPA*, Feb'03), alleging breach of contract for failure to complete an anti-poverty program. The volunteers claimed the foundation agreed to compensate them for transportation and expenses they incurred traveling to planning meetings. Foundation officials say they spent more than $750,000 during two years of a planning process that never yielded measurable progress. They said no grant was ever guaranteed because the process was purely "exploratory." The judge dismissed the volunteers' claims because the statements allegedly made by the foundation were not "sufficiently definite" to constitute a contract or promise. The volunteers say they plan to appeal the case.

Retired Executive Faces Lawsuit for Improper Payments

United Way of the National Capitol Area (District of Columbia) filed a $1.6 million lawsuit last month against its former vice president to recover improper pay the executive allegedly received. The lawsuit claims Oral Suer, who retired in February 2001 after serving with the organization 27 years, never reimbursed cash advances he received. It also charges him with allegedly receiving excessive pension payments and unauthorized pay for vacation and sick leave.

The irregularities came to light after an independent audit ordered by the current United Way board, following allegations and investigations into the organization's financial management. United Way officials say the organization seeks full restitution from Suer.

The audit discovered that Suer received $2.4 million in "borrowed" funds in addition to his normal compensation. Records indicated he repaid only $961,200. The audit states that "a clear lack of transparency, personal accountability, and stewardship" led to the discrepancies.

To salvage their fall fundraising drive in light of these damaging revelations, the United Way chapter mounted a public relations campaign aimed at showing the chapter now operates under new management. The organization has even posted the unflattering audit on its web site.

This proactive response is instructive for nonprofits faced with negative publicity. For further guidance in turning media stumbling blocks into stepping stones, visit our web site at www.gg-law.com. Find other tips in Nonprofit Alert® Memo, Media Relations: Making the Media Work for You, *available exclusively from Gammon & Grange. See back page to order.*

Tax Exempt Issues

Nonprofit Coaching Team Scores Tax Exemption After IRS Challenge

After protracted opposition by the IRS, a nonprofit organization that provides coaching services to leaders of churches and religious organizations has been recognized as tax exempt by the IRS. Ministry Coaching International ("MCI") provides personal coaching/counseling services to church and parachurch leaders, helping them increase personal leadership skills and performance. The organization was modeled after a for-profit entity that provided similar services to business leaders. MCI entered a license agreement with its for-profit model to use of its coaching system, software, and technical support. Although MCI anticipated receiving charitable contributions, it planned to rely on coaching fees as its primary revenue source.

The IRS closely scrutinizes nonprofits engaged in commercial-like activity, international activity, relationships with for-profits, or questionable transactions with insiders.

Because of MCI's relationship with the for-profit entity, the IRS asserted that MCI was simply organized to expand the for-profit's market, and therefore, was not organized exclusively for charitable purposes. The IRS claimed that MCI's board was not independent because several board members had a past or present relationship with the for-profit. The IRS also challenged the reasonableness of the license fee that MCI agreed to pay.

As a result, the IRS imposed several conditions that MCI was required to meet before receiving tax exempt status: (1) remove all references to the for-profit from MCI's web site; (2) require all directors to certify in writing that they understood and would comply with IRS

(continued on page 4)

Highlight of the Month

Volunteer Directors Avoid Personal Liability for Employee's Claim

The Volunteer Protection Act ("VPA") limits the personal liability of volunteer nonprofit directors charged with failure to pay proper wages under the Fair Labor Standards Act ("FLSA"), a federal district court in Arizona has ruled.

The case began in 1996 when the IRS notified the Glendale Youth Center that it owed $70,000 in unpaid payroll taxes and penalties. The president of the Center planned to resign, but agreed to help the organization pay off its debts. She allegedly agreed to work for free during this transition period, but later claimed the board agreed to pay her. After three years, the board still had not paid her, and the center was insolvent so she filed suit against the board members individually.

In their defense, the board members claimed protection under the VPA, which provides relief from liability if a volunteer acts within the scope of his or her responsibility, committing no willful misconduct or gross negligence. The Center's president argued that the VPA only applied to state law claims, not federal issues like her FLSA claim. The court disagreed, holding that the VPA was drafted to preempt both federal and state law, and that it applies to "any" claim against a volunteer, "though its central focus is preemption of state law." *Armendarez v. Glendale Youth Center,* No. CV-99-1379 (5/20/03).

This case marks one of the first federal court decisions interpreting the Volunteer Protection Act, which passed in 1997. The law provides immunity to volunteers for acts or omissions while working within the scope of their volunteer responsibilities so long as they commit no willful misconduct or gross negligence.

However, the Act provides no protection for organizations where they serve. Thus, it is still important for nonprofits to carefully screen and supervise their volunteers to limit liability risks. For further guidance, read Nonprofit Alert® Memo, *Managing Volunteers: Risks & Rewards*. See back page for ordering instructions.

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Coaching Team . . . . . (cont. from page 3)

intermediate sanctions laws and private inurement prohibitions; and (3) pressure to negotiate a lower license fee with the for-profit. After satisfying these final conditions, the IRS finally granted MCI tax exempt status.

The IRS gives more exacting scrutiny to tax exemption applications of nonprofits that are engaged in commercial-like activity, international activity, relationships with for-profit organizations, or transactions with insiders (e.g., compensating officers or directors).

If a nonprofit can be organized at its inception to avoid these four sticky wickets, it should enjoy smoother sailing through the often turbulent waters of IRS passage to exemption.

For an overview of legal considerations involved in obtaining tax exempt status, see Nonprofit Alert Memo, Steps in Organizing a Nonprofit. To order, see the box below, or visit our web site at www.gg-law.com.

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H.R. 7 Update . . . . . (cont. from page 1)

Both H.R. 7 and the CARE Act originally included provisions that would have protected the right of faith-based organizations that receive federal grants to preserve their religious autonomy and make employment decisions on the basis of religion, but those provisions were struck from the final legislation.

President Bush has pledged to sign similar faith-based legislation in the future. As an interim measure, he signed an Executive Order in December, requiring government agencies to respect the religious autonomy of their faith-based grantees.

Find the entire text of H.R. 7 at our web site: www.gg-law.com.

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