



Nonprofit *Alert*®

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

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Scrutiny of Exempt Organizations on the Rise

In recent months, increased scrutiny of the nonprofit sector has been apparent on several fronts. Congress is considering legislation that, if passed, will have a significant impact on many nonprofits. The IRS has reported on its enforcement efforts for 2005 and its enforcement initiatives for 2006. And in the wake of Hurricanes Katrina and Rita, the media are paying closer attention to fiscal responsibility in charitable organizations. Highlights include:

At the IRS: As reported in the November/ December 2005 Nonprofit Alert®, the IRS has issued a new set of guidelines regarding intermediate sanctions and excess benefit transactions. The Service reported that other major focuses in 2005 were abusive tax avoidance transactions (see story below regarding the Abusive Transaction Settlement Initiative), donor advised funds, credit counseling organizations, disaster relief agencies, and political activity compliance. For 2006, the Service has announced that major emphasis will be placed on oversight of façade and conservation easements, charitable trusts, abusive transactions by accommodation parties, and hospital compensation structures.

In the News: The acting CEO of the Red Cross has resigned. The organization is alleged to have neglected minorities in rural areas in the response to Hurricanes Katrina and Rita. On another front, Chairman Grassley of the Senate Finance Committee has called for an investigation into the compensation and severance package of former American University ("AU") President Benjamin Ladner. Grassley sent a letter to AU with numerous information demands and noted that the AU board could be a "poster child for why [exempt organization] review and reform are necessary."

On the Hill: As reported in previous editions of the NPA, in 2004 the Senate Finance Committee invited a Panel on the Nonprofit Sector to provide recommendations for reform of the EO sector, and in June 2005 the Panel submitted its report to the Committee. A significant number of the Panel's recommendations can be found in charitable reform measures that were made a part of S.2020, the "Tax Relief Act of 2005." The Act was passed in the Senate on November 18, 2005, but the future of its EO provisions (which include not only reform measures, but also certain incentive measures previously proposed in the CARE Act) is uncertain. The companion tax bill in the House (H.R. 4297) contains no EO provisions, so the bill must now proceed to conference to reconcile the Senate and House versions. Among the key provisions in S.2020 affecting charitable organizations are:

- **Non-Itemizer/Itemizer Deduction.** Creates a charitable deduction for cash donations over \$210 (\$420 for joint filers) made by non-itemizers. The \$210 floor would also apply to itemizers.

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Exempt Organizations....continued

- **Tax-Free Distributions from IRAs for Charitable Purposes.** Provides an exclusion from gross income for certain charitable distributions from an IRA.
- **Involvement by exempt organizations in tax-shelter transactions.** Subjects tax-exempt entities to penalties for participating in a prohibited tax-shelter.
- **Reform of Certain Life Insurance Contracts.** Imposes an excise tax on the taxable acquisition of any interest in a life insurance contract in which an applicable tax-exempt organization held an interest in the contract.
- **Penalties Applicable to Private Foundations.** Doubles the excise taxes applicable to certain activities by private foundations.
- **Clothing and Household Items.** To be eligible for a contribution deduction, a donor must receive substantiation from the donee-charity of any donation of clothing or household goods valued at over \$250, including a notation of the condition of the items donated. The proposal also requires the Secretary to prepare and publish an itemized list of clothing and household items and assign an amount to each item on the list. With certain exceptions, any deduction may not exceed the item's assigned amount. If the item is not "in good condition," the donor would be limited to taking a deduction equal to twenty percent of the list value.
- **Partial Interest in Donated Property.** Requires that charities receiving a fractional interest in an item of tangible personal property take actual possession of the item for a period of time corresponding substantially to the charity's percentage interest in the item.
- **Appraisal Reform.** Lowers the thresholds for penalties on taxpayers who over-value in-kind contributions.
- **Donor-Advised Funds.** Provides for significant additional requirements on donor advised funds including minimum distribution mandates and prohibitions on certain DAF distributions.
- **Donor Recordkeeping Requirement.** To substantiate a contribution deduction, requires taxpayers to maintain documentation of any cash contribution, which may be in the form of a cancelled check or written verification from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution.

Our next edition of the NPA will likely be able to report which, if any, of these provisions survive the conference committee and are enacted into law.

CA Decision on Episcopal Church Splits

In a property dispute between the Episcopal Diocese of Los Angeles and two parishes, All Saint's Church in Long Beach and St. David's Church in North Hollywood, an Orange County, California Superior Court ruled that the individual parishes, and not the Diocese are the rightful owners of their church buildings and other related property. The parishes left the Episcopal Church U.S.A. and affiliated with the Anglican Church in Uganda after a controversy over the ordination of a homosexual bishop. The Diocese has said that it plans to appeal the decision.

Terrorism Guidelines Released

On December 5, 2005 the U.S. Department of Treasury issued a revised set of guidelines for charitable organizations seeking to comply with the USA Patriot Act and protect themselves against inadvertently aiding terrorist-related organizations. The guidelines include suggested best-practices for financial and personnel decisions, distribution of funds, and monitoring of fund recipients, as well as a link to the Office of Foreign Assets Control Specially Designated Nationals List. Such guidelines may be especially applicable following the tsunami in Southeast Asia, and the earthquake in Pakistan, where fears exist that grants for charitable purposes may find their way into terrorist-related networks. These voluntary guidelines are effective immediately, but there is a public comment period open until February 1, 2006.

⇒ Electronic submissions may be submitted at:
<http://www.treas.gov/offices/enforcement/key-issues/protecting/charities-intro.shtml>

⇒ A copy of the draft Guidelines can be found at:
http://www.treas.gov/offices/enforcement/key-protecting/docs/guidelines_charities.pdf

Study Finds Donor Intent Important, Public Expects Accountability from Charities

A survey commissioned by the plaintiffs in one of the largest donor-intent cases in U.S. history (*Robertson v. Princeton University*) finds that when conditions are placed on donations, donors expect their wishes to be respected. Not surprisingly, ninety-seven percent (97%) of individuals polled said that it was a “very” or “some-what” serious matter when a charity used funds specified for particular projects for other than the designated purposes. Fifty-three percent (53%) said they would “definitely stop giving” while twenty-six percent (26%) said they would “probably stop giving” if a charity misused specially designated funds. Sixty percent (60%) of respondents said they felt a charity should “definitely” or “probably” return a donation earmarked for a particular purpose if not used for that purpose. Forty-seven percent (47%) of those polled felt that legal and criminal sanctions are in order when nonprofit executives misuse funds earmarked for special purposes, while twenty-four percent (24%) felt the executives should be legally, but not criminally, accountable.

“...donors expect their wishes to be respected”

➤ For more information on handling donor designated funds, see *Nonprofit Alert® Memo, Donor-Designated Gifts: Pitfalls & Provisos.*

Salvation Army Employment Discrimination/Retaliation Case

In the November/ December 2005 *Nonprofit Alert®*, we reported that a New York court had upheld the right of The Salvation Army (“TSA”) to utilize religious criteria in employment decisions. However, in a recent ruling, a different New York court found that a former employee of TSA alleged facts sufficient to bring claims for discrimination based on his sexual orientation and religious background (the employee is homosexual and Jewish) under the New York State Human Rights Law and the New York City Human Rights Law. The plaintiff alleged that a TSA supervisor created a hostile work environment, and that when he expressed his concerns to the supervisor’s

“Religious exemptions are a far cry from letting employers harass their employees.”

superiors, he was fired in a retaliatory manner. Although TSA cited exemptions from the two Human Rights Laws for religious employers, the court noted that the “exemptions for religious organizations are a far cry from letting [an employer] harass their employees and treat the employees in an odiously discriminatory manner during their employment, and to use derogatory expressions toward the employees.” Because the court found that the plaintiff had pled sufficient claims for sexual orientation and religious discrimination, as well as for actionable retaliatory conduct under both the New York State and City laws, the case may move to trial.

➤ For more information on employment decisions of religious organizations, see *Nonprofit Alert® Memo, Hiring and Firing: Rights of Religious Employers.*

IRS Grants Exempt Status to Christian Coalition International

On September 15, 2005, the IRS granted tax-exempt status to the Christian Coalition International (“CCI”) as an IRC Section 501(c)(4) organization. This ruling addresses questions regarding CCI’s tax-exempt status stemming from alleged political activity, related to distribution of voter guides in churches. The one-page exemption ruling cited “revised operations described in [the] application for tax-exempt status” as key to the determination. The revisions in voter guides include: candidate surveys that will present a broad range of issues without evidencing a bias towards any particular viewpoint; the ability for candidates to provide additional comments beyond “yes” or “no” answers; and, printing the entire question asked of candidate, rather than a summary.

➤ For more information on political activity by EOs, see *Nonprofit Alert® Memo, Nonprofit Lobbying and Political Activity – Know Your Limits.*

Legislative Action on “Hate Crimes”

On September 14, 2005 the House passed the Local Law Enforcement Act as an amendment to the Child Safety Act (H.R. 3132). The Child Safety Act is focused on such things as the enforcement of a national sex-offender registry, the prevention sex-trafficking of children, and the collection of DNA samples of regis-

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Hate Crimes...continued

tered sex-offenders. Rep. John Conyers (D-MI), however, attached an amendment, which passed by a vote of 223 to 199, which adds the classifications of sexual orientation and gender identity (i.e. cross-dressing; trans-sexualism; trans-genderism) to existing federal hate crimes law. Current law makes it a crime to injure or intimidate a person based on their race, color, religion, or national origin (18 USC § 245). The companion Bill in the Senate, S. 1145 (Local Law Enforcement Enhancement Act of 2005), currently does not include the “gender identity” language, but would add the sexual orientation language to the hate crimes law. The Bill has been referred to the Senate Committee on the Judiciary.

Several groups have pointed out that hate crimes legislation in countries such as Sweden and Canada have led to prosecution of religious leaders for speaking out against homosexual and trans-gender practices. The oft cited case of Swedish minister Ake Green, who was prosecuted for comments he made during a sermon, was recently thrown out (5-0) on appeal by the Swedish Supreme Court because the court said that it was not illegal under the law to offer one’s interpretation of the Bible and urge others to follow it.

Update on Vehicle Donations:

IRS Vehicle Donation Warning

Under the American Jobs Creation Act of 2004, the IRS is operating under a new set of rules designed to curb valuation abuses on vehicle donations. Under the new rules, a donor is only permitted to deduct up to the amount a donee organization receives when selling the vehicle, not the fair market value. Under an exception to the rule, the donor may be permitted to claim a deduction for fair market value if the vehicle is sold by the donee charity significantly below market value

“Unfortunately our worst [loss of income from vehicle donations] fears have come true”

to a needy person, in furtherance of the charity’s exempt purposes. The charity must substantiate such a sale for the donor. The IRS has taken a position that

vehicles sold at auctions do not meet the “significantly below market value” criteria, and that a charity providing documentation other than the actual gross proceeds at sale may face penalties.

Impact of Vehicle Donations Deduction Limitations

Since the implementation of revised deduction allowances for vehicle contributions to charitable organizations, charities have experienced a significant decline in vehicle donations, according to a statement by Volunteers of America’s Vice-President for public policy, Ronald H. Field. He states that “our worst fears [loss of income from vehicle donations] have come true.” The new rules have caused a thirty to forty percent decrease in vehicle donations to organizations such as the Volunteers of America.

➔ For more information regarding the new requirements for vehicle donations, see *Nonprofit Alert® Memo, Charitable Gifts: Receiving & Receiving*

Katrina Legal Aid Resource Center

Families and individuals affected by hurricanes Katrina and Rita are in need of legal aid to sort through complex issues such as acquiring legal aid, housing, welfare, unemployment, and insurance benefits, among other issues. The American Bar Association, Legal Services Corporation, National Legal Aid Defender’s Association, and Probono.net have created an online resource clearinghouse to aid individuals afflicted by hurricanes Katrina and Rita, as well as a registration tool aimed at pairing attorneys wishing to provide pro bono legal services with individuals in need of services in the attorney’s practice area.

➔ For more information, visit:
<http://www.katrinalegalaid.org/>

IRS Abusive Transaction Settlement Initiative

Through January 23, 2006 the IRS will accept settlements (including full payment of taxes owed, interest, and a reduced portion of the standard penalty) from taxpayers who have participated in abusive tax shelters. This initiative results from a 30-month IRS strategy to enhance enforcement and deter abusive tax shelters. Of particular note to exempt organizations are the settlement initiatives relating to abusive conservation ease-

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IRS...continued

ments, abusive donations of patents and other intellectual property, certain distributions by charitable remainder trusts, health care reimbursements, offsetting foreign currency option contracts, and transportation reimbursements.

➤ For more information, visit:

<http://www.irs.gov/charities/article/0,,id=150608,00.html>

Increase in IRS User Fees in 2006

The OMB has directed federal agencies such as the IRS to charge user fees that more accurately reflect the value of services rendered where those services convey special benefits to the user rather than the general public. Several fee increases affecting nonprofits include increased fees for private letter ruling requests (now \$8,700 up from \$2,750), Form 1023 exemption determination applications, changes in business accounting methods, and employee plan opinion letters. Any organization considering a Private Letter Ruling should note that the fee increase for Private Letter Ruling requests will be effective February 1, 2006.

➤ For more information, visit:

http://www.irs.gov/pub/irs-news/irs_tege_user_fees.pdf

MacDowell Colony Faces Local Tax Scrutiny

The MacDowell Colony located in Peterborough, New Hampshire is facing the revocation of property tax exemption, and assessment of unpaid past taxes. At dispute is whether the colony of artists, founded in 1907, where attendees enjoy an rent-free time to cultivate their artistic abilities, actually benefits the public, or whether it merely benefits the individual members of

the colony. The town has offered a settlement proposal of approximately one-third of the allegedly past due taxes. The Colony is expected to appeal the town's determination.

➤ Exempt Organizations should be aware that state and local requirements for property and sales tax exemptions may differ from IRS criteria.

Knights of Columbus Canadian Facility Rental Decision

An Ontario, Canada branch of the Knights of Columbus ("K of C") recently found itself in litigation over denial of the use of its facilities to a gay couple wishing to hold a wedding reception. The K of C maintained that they had a bona fide reason for denying the couple use of its facilities, namely religious and moral values. Since the facilities were ordinarily available to the general public, the K of C argument was weakened. Although this is a Canadian case, it points out the need for organizations wishing to exclude use of their facilities to others based on religious and moral convictions to carefully examine their facilities use policies. Features of a facility use policy may include restricting use to organization members only, implementing and documenting an acceptable use policy, and employing a consistent screening process.

➤ For more information, see "*Knights of Columbus Decision and the Implications for Churches and Religious Charities that Rent Out their Facilities*", published by our friends at the law firm of Carters P.C. which deals in charity and non-profit law across Canada, and is available on the web at www.carters.ca.

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