



Philanthropic NEWS

**WINTER
2005 - 06**

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GRASSLEY TO SEEK MORE CHARITABLE REFORMS INCLUDING EXECUTIVE COMPENSATION CHANGES

Senate Finance Committee Chairman Charles Grassley (R-Iowa) said Jan. 12 that progress on charitable sector reforms, which his committee has been examining in recent years, probably will be a "piecemeal" approach of correcting perceived problems as opposed to one "gigantic" bill.

Asked about executive compensation, Grassley said he thinks the committee will seek to compel tax-exempt organizations' boards of directors to justify their executives' compensation packages without an outside consultant defining what that compensation should be. That practice is often the justification for paying executives almost any amount of money, "even ridiculous amounts of money," he said.

"So we're going to put more of a burden on the judgment of the board of directors so they don't have a crutch of somebody advising extraordinary salaries. And in the final analysis, we think we're going to get a more market-based--something that's reasonable within the geographic area, and save a lot of money that should otherwise go to charitable causes," he said.

IRS CREATES SAFE HARBOR FOR JOINT VENTURES INVOLVING NONPROFITS

The Internal Revenue Service (IRS) has provided a "safe harbor" for tax-exempt organizations entering joint ventures with for-profit corporations.

In its ruling, the IRS provides the "safe-harbor" by which a new, for-profit Limited Liability Company (LLC) can be formed by a charity and for-profit entity without jeopardizing the nonprofit organization's tax-exempt status or subjecting its revenues (or profits) to Unrelated Business Income Tax (UBIT).

The following seven elements must be present in this type of joint venture to prevent a nonprofit organization from either losing its 501(c)(3) tax-exempt status or subjecting itself to UBIT:

- The activities conducted by the nonprofit through the LLC cannot constitute a substantial part of the nonprofit's activities. It must still primarily engage in a tax-exempt purpose;
- Any activities that the nonprofit participates in or conducts through the newly established LLC must be substantially related to the nonprofit's tax-exempt purposes and functions; otherwise, profits will be subject to UBIT;
- The nonprofit organization must maintain control sufficient to ensure the furtherance of its charitable

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SAFE HARBOR REQUIREMENTS

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purposes. Essentially the nonprofit should retain sole discretion over all decisions contributing importantly to its exempt purpose;

- Any and all contracts that the newly formed LLC enters into must be at arm's length and for fair market value;
- The LLC's governing documents should limit the nonprofit's participation to only those activities that will not jeopardize the organization's tax exemption;
- The ownership interests in the LLC must be proportional to the respective capital contributions, and all revenue generated by the LLC or capital returns must be distributed according to these proportional ownership interests. It is important that any disbursement be to the nonprofit entity and not to a private individual, which would constitute private inurement and place that nonprofit in breach of its tax-exempt status; and
- There should be a showing that the purpose of the LLC is in furtherance of the nonprofit's charitable purpose and that this venture will expand the nonprofit's ability to accomplish that purpose.

The ruling itself can be found at http://www.irs.gov/irb/2004-22_IRB/ar08.html. For more information, contact Allen R. Bromberger at 212-889-0575.

APPEALS COURT UPHOLDS LAW RESTRICTING TELEMARETERS

The 8th Circuit Court of Appeals has upheld a North Dakota law barring telemarketers from soliciting on behalf of charities from citizens listed on the State's do-not-call list. In Fraternal Order of Police, N.D. State Lodge v. Stenehjem, 431 F.3d 591 (2005), the appeals court rejected the argument of the North Dakota Fraternal Order of Police and the Veterans of Foreign Wars that the law violated the first amendment free speech rights of charities, stating that the law "significantly furthers the state's interest in residential privacy."

The statute is aimed at paid telemarketers. It permits volunteers and employees of charities to continue making calls on behalf of their organizations, regardless of the do-not-call list. Lawyers for the plaintiffs indicated that they may appeal the case to the United States Supreme Court.

FEDERAL GOVERNMENT DROPS WATCH LIST REQUIREMENT

The federal government has dropped a requirement that nonprofit organizations participating in the Combined Federal Campaign (CFC) check their employees' names against government terrorist suspect lists and certify that they do not knowingly support or employ people listed on certain government terrorist watch lists.

Nearly 165 organizations opted to drop out of the CFC program this year rather than comply with the requirement and 13 other organizations sued the federal Office of Personnel Management. They objected to the requirement as a vague, unreasonable, and unconstitutional burden on their expressive and associational activities that violates the First and Fifth Amendments, which purported to regulate funds that were not received through the CFC program. Jennifer Lowe, policy analyst for OMB Watch, said the rule required nonprofits to act as quasi-arms of law enforcement, yet most charities operate on budgets too small to perform such policing.

IRS WARNS OF QUESTIONABLE DEDUCTIONS FOR DONATED VEHICLES

In response to questionable practices by donors and charities, the Internal Revenue Service ("IRS") has announced that it will not recognize certain deductions that taxpayers may be claiming relating to donated vehicles sold at auction.

The IRS specifically pointed to the practice of some charities that sell donated vehicles at auction and claim that the sales are to needy individuals at prices significantly below fair market value. By doing so, these charities claim that the sales trigger an exception to the general rule that the deduction allowed to the donor is limited to the proceeds from the charity's sale. The IRS' position is that vehicles sold at auction are not sold at prices significantly below fair market value. Therefore, the IRS will not treat vehicles sold at auction as qualifying for the exception for sales to needy individuals at prices below fair market value.

The IRS has stated that because this exception does not apply to sales at auction, the charities involved may be subject to penalties under sections 6701 and 6720 of the Internal Revenue Code if the charity provides the donor an acknowledgment indicating anything other than that the deduction may not exceed the gross proceeds from the sale.

NEW YORK NONPROFITS MUST COMPLY WITH NEW EDUCATION LAW

Effective January 1, 2006, any entity, nonprofit or for-profit, must obtain the consent of the Commissioner of Education before it may use any of the following words in its name, or any abbreviation or derivative of the words: "School," "Education," "Elementary," "Secondary," "Kindergarten," "Prekindergarten," "Preschool," "Nursery School," "Museum," "History," "Historical," "Historical Society," "Arboretum," "Library," "University," "Conservatory," "Academy" or "Institute."

The new law also requires any chartered education corporations currently operating under an assumed name to file a copy of their assumed name certificate with the Education Department. The law gives these corporations one year to comply.

The new law also prohibits any person or corporation from using the names "museum" or "arboretum" or any similar name unless they are authorized in writing under a special legislative charter or Regents charter to operate such an entity or otherwise are granted the right to do so by the Board of Regents or Commissioner of the Department of Education. The law includes groups that are "Friends of the ___ Museum", who would need the Education Department's authorization to use the name, but would not necessarily need to be chartered by the Board of Regents.

The text of the bill can be found at <http://www.assembly.state.ny.us/leg/?bn=A01794&sh=t>. For more information, contact Karen I. Chang at Karen@perlmanandperlman.com.

NEW YORK DISSOLUTION BILL IS SIGNED INTO LAW

On October 11, 2005, New York Governor George Pataki signed into law a dissolution bill which provides for simplification of the dissolution process for New York charities. Most significantly, Supreme Court review of dissolutions by corporations without assets will no longer be required. The New York State Attorney General is now authorized to approve such dissolutions without a court order.

The law becomes effective April 11, 2006. For more information, contact David G. Samuels at David@perlmanandperlman.com.

NONPROFITS SHOULD FOLLOW PROCEDURES TO ENSURE PAYMENT OF REASONABLE EXECUTIVE COMPENSATION

The Internal Revenue Code prohibits the payment of excessive compensation and other transactions that provide excessive benefits to executives and other insiders, such as directors. However, charitable organizations are permitted pay "reasonable" compensation for services provided by their staff.

The Internal Revenue Service ("IRS") defines "reasonable compensation" as the amount that would ordinarily be paid for like services by like enterprises under like circumstances.

Charitable organizations are also prohibited from providing excessive compensation or benefits to family members of individuals who have substantial influence over the organization's affairs. Violations of these rules can amount to fines on the charity, the person receiving excess compensation and, under certain circumstances, board members.

In order to protect itself and its staff from liability and penalties, a board of directors would be well advised to undergo a careful process to arrive at the amount it will pay its executives. The board should (i) base the compensation on appropriate comparable data of other employees similarly situated and (ii) document the basis for its determination by preparing contemporaneous minutes of the meeting at which the decision was made. Although these procedures are not required, following them is a good governance practice and can prove invaluable in the event of an IRS inquiry.

Federal regulations define comparable data needed to determine the reasonableness of compensation or other transactions with corporate insiders as including (i) compensation paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; (ii) the availability of similar services in the geographic area; (iii) current compensation surveys compiled by independent firms; and (iv) actual written offers from similar organizations competing for the disqualified person. Organizations with gross receipts (including donations) of less than \$1 million may rely on the compensation paid by three comparable organizations in the same or similar communities for similar services when approving compensation arrangements. For other organizations, the regulations do not specify the number of comparables or comparability sources required, but certainly three would be a minimum.

UPCOMING SPEAKING ENGAGEMENTS AND ANNOUNCEMENTS

Seth Perlman will be speaking at several conferences in the upcoming months, including:

- A presentation as Keynote Speaker at the **Kintera User Conference 2006**, "Revolution In Giving," on February 28, 2006.
- A presentation with the New Hampshire Director of Charitable Trusts, Mike DeLucia, on trends in fundraising law at the **AFP International Conference on Fundraising** from April 2-5, 2006.
- A presentation on cause-related marketing issues at the **DMA Nonprofit Federation Conference**, "Critical Issues Facing Nonprofits," on April 19, 2006.
- A presentation with Karin Goldman from the NYS Attorney General's office on multi-state reporting, registration and compliance at the **AICPA External Reporting Conference** on April 27, 2006.

David Samuels will be giving a presentation on compensation and benefits at the **AICPA Not-For-Profit Governance Forum** in New York City on May 4-5, 2006.

Allen Bromberger will be presenting an advanced workshop on "Hybrid business entities" at the **7th Annual Gathering of the Social Enterprise Alliance** on March 9, 2006. Mr. Bromberger's article entitled "Raising Capital: Regulatory Issues" will be published in the February 2006 edition of the Social Enterprise Reporter.

Daniel Alcott will be presenting an advanced workshop on "Raising Capital for the Social Enterprise" at the **7th Annual Gathering of the Social Enterprise Alliance**.

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PHILANTHROPIC NEWS
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