THE HOWE & HUTTON REPORT

ANALYZING LEGAL NEWS OF IMPORTANCE TO THE NONPROFIT COMMUNITY

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THE LAW FIRM FOR ASSOCIATIONS®

IN THIS ISSUE:

EXPEDITED DEDUCTIONS ALLOWED FOR HAITI CONTRIBUTIONS – Federal legislation now allows taxpayers making charitable donations for Haiti relief to claim deductions on their 2009 returns for donations made after January 11 and before March 1, 2010, or deductions can be claimed on 2010 returns instead. Contributions must be made specifically for the relief of victims in areas affected by the January 12 earthquake, and contributions must be in cash (including donations by text message, check, credit card or debit card), as opposed to property. Expedited deductions are available only to taxpayers who itemize and not to those taking the standard deduction. The IRS has further warned taxpayers that only qualified American nonprofits can receive deductible contributions. Contributions to foreign organizations are nondeductible. *As in the case of previous natural disasters around the globe, Americans are opening their hearts and wallets to help those in need. But history has shown that donors and legitimate charities may be contacted by some people fraudulently claiming to be collecting for Haitian relief efforts. Caution is advised for all who are thinking about contributing funds to assist Haiti's earthquake victims.*

COURT STRIKES DOWN INCREASED LOBBYING FEE – *H&H Report Update* – A federal district court judge in Chicago has enjoined the State of Illinois from collecting an increased annual lobbying registration fee that would otherwise have gone into effect this year. The judge found that the increase (from $150 to $1,000 per year for nonprofits and from $350 to $1,000 for individuals and other organizations), was unreasonable and unconstitutional as an infringement of free speech rights. The judge also found that she had no authority to reinstate the previous lower fee schedule that was superseded when the General Assembly approved the increase. Consequently, the judge concluded that the effect of her ruling, for now, was to prevent collection of any lobbying registration fee, pending possible further efforts by the State to avoid or minimize the substantial harm that the judge conceded would be caused to the State's operations as a result of her decision. *No registration fee at all? You can bet that result won't stand for long. The old schedule for registration fees may be brought back by legislative or judicial action, or the judge's decision could be appealed, which might eventually result in collection of the increased fee. Stay tuned.*

GOOD READING... See you in... March

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CLAIMS AGAINST NONPROFIT PUBLISHER DISMISSED – A Pennsylvania federal district court has dismissed antitrust and false advertising claims filed by a cancer researcher against a nonprofit dedicated to advancing such research. The researcher alleged the nonprofit published a "plagiarized and falsified research paper" and refused to print the researcher's letter to the editor responding to that publication. But the court said that even if the researcher's claims were true, they did not amount to a violation of federal law, as the antitrust laws were designed to remedy harm to competition in a relevant market rather than personal injuries, and false advertising under the federal Lanham Act did not include misrepresentations in books or articles. The court recognized that there might have been some claim under Pennsylvania law here, but such a claim should have been brought in state court. *The federal antitrust laws are interpreted to protect competition generally, not individual competitors. This distinction is often not understood or accepted by individual persons or companies alleging antitrust injuries. Some states' antitrust and other laws do protect competitors. It helps to recognize the difference when filing or defending a claim.*

HOW LONG DOES A MERGED NONPROFIT "EXIST"? – The Supreme Court of Illinois recently considered some almost metaphysical issues involving a gift to a nonprofit that subsequently was merged with another entity and, arguably, ceased to exist. A bank trustee sought a court order that it did not have to distribute income from certain farmland to Kids Hope United-Hudelson Region ("Kids Hope"), a nonprofit resulting from the merger of Edgar County Children's Home ("ECCH") with a similar charitable entity. The trustee noted that the income had been willed to ECCH, but ECCH no longer existed as a corporate entity after the merger, and the will contained provisions giving the income to other charitable beneficiaries if ECCH "should cease to operate or exist." The Supreme Court, though, reversed a lower court's decision to grant the trustee's request that it be allowed to distribute income to other charitable entities, finding that even though ECCH did not exist as a corporate entity after the merger, it did not "cease to operate or exist" within the meaning of the will's language. On the contrary, the Supreme Court said that a charity does not "cease to exist" as a result of a merger for the purposes of receiving a bequest unless the corporation surviving the merger is no longer "suited" to carry out the purposes of the bequest. And, in this case, the Supreme Court found that Kids Hope was so suited because the merger agreement "guarantee[d] that ECCH's mission…will be continued for as long as it is financially feasible to do so;" part of the object for which ECCH was established was to provide permanent foster homes for dependent children; and Kids Hope placed children in approved foster homes. The lone dissenting justice came to a different conclusion, noting that Kids Hope had closed and sold a children's home that had previously "embodied" ECCH. According to the dissenter, ECCH "ceased to exist," as the decedent knew it, when the home was sold, if not at the time of the merger, and the alternative beneficiaries should receive the income. The dissenter said the Supreme Court majority would find that nonprofits continue to exist "if we can still hear the faint echo of their demise. If a mere specter of the original charity survives, if it provides a mere pittance of the original benefit to those for whom it was intended, it lives on in some ethereal plane..." *The dissenter's ghostly metaphor may have been mostly for entertainment purposes. But courts following the majority ruling in this case certainly may be more disinclined to hold that a gift has lapsed because of a nonprofit's merger or consolidation, even when a donor has taken the trouble to specify contingent beneficiaries. Furthermore, we fear that the dissenter may have been right in a further comment that the decision will compel attorneys, at additional expense to their clients, to spend more time drafting wills that "specify the meaning of existence."*

NONPROFITS MUST REPAY "DIRTY" DONATIONS – A bankruptcy trustee in South Florida is now trying to "claw back" millions of dollars in donations made by disbarred attorney Scott Rothstein to hospitals, schools and charities from money he "earned" through allegedly fraudulent schemes. The trustee wants the money back to compensate Rothstein's victims, and some nonprofits have voluntarily returned contributions to the trustee, acknowledging that they received "dirty" money. Other nonprofits face the possibility of a lawsuit by the trustee, have already spent the donated funds, and may lose millions more dollars in federal matching funds if they have to give up Rothstein's contributions. *Bernie Madoff and others have made headlines by stealing money from nonprofits. But sometimes criminals (including such noteworthies as Al Capone) have given to nonprofits as well, for tax reasons, or because they want to compensate for the harm they have done in making their money, or just to gain some positive publicity. It's worth noting that, in doing so, they may actually cause more trouble for the nonprofits involved.*

"JILTED DISTRIBUTOR" UNSUCCESSFUL IN SUING ASSOCIATION – A federal appeals court in Cincinnati has upheld a lower court's decision to throw out a suit against an association acting as the national governing body of stock car racing and a national racetrack managing company accused of conspiring to violate the antitrust laws. Suit was brought by an independent automotive racetrack owner, which said the defendants conspired to deny its applications to host a premium stock car race, allegedly costing the racetrack owner at least $175 million. But the appeals court said the owner's suit failed because it did not adequately define the relevant markets in which the defendants' conduct allegedly restrained or monopolized trade, saying alleged relevant markets relating only to automobile racing appeared to be too small for consideration, since stock car races competed with other forms of entertainment. Further, the appeals court questioned whether the defendants were separate entities legally capable of conspiring with each other, and whether the racetrack owner wasn't just a "jilted distributor" that was bypassed as a host for a race in favor of its competitors, in which case the injury it alleged was not the type antitrust laws were intended to prevent. *Nonprofits that regulate a business or profession are frequent targets for private antitrust suits, and, fortunately for them, plaintiffs who bring such suits have to clear numerous barriers in order to succeed. Some of them came into play in this case. These suits can be extremely expensive to defend, however, and damaging to a nonprofit's reputation, even if the association "wins." Be sure your business policies and liability insurance pass muster. We can help.*

Regulatory Law Developments

THIS TIME THEY MEAN IT! – *H&H Report Update* – The current revised deadline for Federal Trade Commission enforcement of the "Red Flags Rule" fast approaches – at last look, it was June 1, 2010. Four times postponed by the FTC because of association opposition and concerns in Congress, the enforcement of the "Red Flags Rule" would require many nonprofits, among others, to implement written identity theft prevention programs approved by their boards of directors. Such programs must involve identifying the "red flags" of identity theft relevant to each organization; creating procedures for detecting those red flags; establishing procedures to prevent and mitigate identity theft; and periodic program updating to account for changes in business practices, technology and the activities of identity thieves. *If your nonprofit provides benefits to any individuals, including membership benefits, and tries to collect payment later, it may be a "creditor" subject to the Rule. We can help you assess your organization's liability for compliance and develop identity theft prevention programs, as necessary.*

FTC BURNS INDOOR TANNING GROUP – An association of indoor tanning businesses has agreed that it will settle charges filed against it by the Federal Trade Commission for allegedly failing to disclose material facts and making misrepresentations in an industry advertising campaign. The FTC challenged association claims that indoor tanning is approved by government agencies; indoor tanning is safer than tanning outdoors; vitamin D supplements may harm the body's ability to fight disease; and the risks of not getting enough ultraviolet light "far outweigh" the "hypothetical" risk of skin cancer. Under a proposed consent order resolving the FTC's charges, the association would be prohibited from making the challenged representations and would be required to include in ads about the safety or health benefits of indoor tanning a notice that exposure to ultraviolet rays may increase the likelihood of developing skin cancer and cause serious eye injury. Additionally, in ads making claims about vitamin D, a notice would be required stating that tanning isn't necessary for the body's generation of vitamin D. *Associations engaging in industry advertising must make sure that claims made are demonstrably true, because substantial fines and adverse publicity may result if they are not.*

Employment Law Developments

HERE WE GO AGAIN ON INDEPENDENT CONTRACTOR ABUSES – There are numerous reports that the Internal Revenue Service and as many as 37 states are going to crack down on employers which misclassify employees as independent contractors. Misclassification, whether deliberate to avoid taxes or lower costs, or due to ignorance of what the law requires, has consequences for employers, employees and federal and state governments. Employers avoid paying federal income tax withholding and Social Security taxes on pay attributed to independent contractors vs. employees, as well avoiding workers' compensation and unemployment insurance payments, thus lowering their costs. Contractors are responsible for paying the employer's and employee's share of such taxes, and are obliged to pay estimated taxes on income on a pay-as-you-go basis. Employees also lose other benefits provided to employees, e.g., vacation, pension and health care benefits. Federal and state governments often receive lower revenues when independent contractors fail to withhold or pay estimated taxes or make unemployment insurance and workers' compensation payments. *So there are incentives for federal and state governments to look for misclassifications and go after employers with penalties including fines and interest for misclassification of workers. One likely source leading to an investigation: workers who believe they are misclassified, especially if they are moved from employee to independent contractor status, and therefore inclined to complain to federal or state regulators. Get good advice on proper classifications.*

Meeting & Travel Law Developments

WHAT DID THEY EXPECT WITH SUCH DRACONIAN PENALTIES? – *H&H Report Update* **–** You did not need a fortune teller to predict what would happen when last December the Department of Transportation imposed a $27,500 fine per passenger on airline flights with tarmac delays over three hours. That amounts to some $2.75 million for a 100-passenger regional jet. Go figure for a bigger jet. Now the media are reporting over 15,000 flight cancellations linked to the winter storms which have been unusually severe in many parts of the country, e.g., D.C., New York, Chicago, Atlanta and Dallas, to name a few. Cancellation means no fine, and passengers have to rebook. One airline reportedly cancelled more flights in one day than it formerly cancelled per year. *Be careful what you ask for. You might get it. At least one of the passenger advocates who most strongly pushed for the tarmac delay penalty scheme now says airlines don't need to cancel flights to prevent tarmac delays. At $2.75 million or more, why should airlines take a chance? Alternative ways to hold meetings may grow in popularity as flying becomes even more of a hassle.*

Tax Law Developments

COURT SCOLDS IRS FOR ARGUING AUDIT INCENTIVES "MAXIMIZATION" – A federal court of appeals recently took the IRS to task for arguing, in a dispute over a charitable deduction in an estate tax case, that applicable law had to be interpreted to "maximize incentives" for the IRS to audit estate tax returns. The decedent, expecting her daughter to disclaim a portion of her inheritance, had named a charity to receive 25 percent of any disclaimed amount. But a delay in valuation of the estate's assets and exercise of the disclaimer resulted in the estate's seeking an increase in the value of a charitable deduction it originally claimed, which the IRS denied, saying that the donation was uncertain at the time of death because the amount to be donated was unknown. Also, said the IRS, any ambiguity in the law as applied to this case had to be resolved in favor of a lower deduction to maximize the IRS's incentives to audit estate tax returns. Nixing that theory, a federal appellate court in St. Louis said the applicable laws were "clear and unambiguous" in providing that a deduction should not be denied merely because the amount of that deduction depended on asset valuation and exercise of a disclaimer after the date of death. Furthermore, the court said that an adjustment increasing charitable deductions and not audit collections should not be viewed as somehow violating public policy, as the IRS's role was not necessarily to maximize audit collections, but to fairly enforce tax laws, even if it could "marginally detract" from audit incentives. *In a variety of contexts, the IRS has argued a "tie goes to the IRS" rule for interpreting ambiguities in tax law. This appellate court did not buy that argument, and its decision provides helpful language for taxpayers to quote in opposition in other cases.*

Intellectual Property & Computer Law Developments

FOUNDATION HAS RIGHT TO SHARE EARNINGS OF PATENT CO-OWNER – Nonprofits produce a large amount of intellectual property, but they sometimes contract with for-profit entities for the exploitation of patents, trademarks and copyrights. Such an arrangement was involved in a recent case decided by the federal court of appeals in Chicago, in which a foundation affiliated with a state university sued a patent management company over income derived from an enzyme with cholesterol-reducing benefits that were discovered by university scientists. The foundation and the for-profit were co-owners of the patent for the discovery, but they went to court when the for-profit denied the foundation any share of revenue the for-profit gained from licensing the management company's patent rights and also asserted sole ownership of certain therapeutic compounds developed from the enzyme. The appellate court said that the general statutory rule applying to the rights of patent co-owners is that each co-owner can freely use and exploit the patent without regard to the other, which would have favored the management company in this case. But the appellate court said that, despite the statutory rule, contracts between the parties and other persons in this case gave the foundation a right to a share of the company's profits from licensing or sublicensing its patent rights and from resulting products – including license fees, "milestones," and royalty payments received by the management company from its own licensee before products were brought to market under that license. The court reached that conclusion even though the contracts did not expressly revoke the company's statutory right to freely license or sublicense its interest in the patent, noting that those contracts explicitly deprived the foundation of its own statutory right, as co-owner of the patent, to market the discovery, and gave the for-profit a valuable "exclusive" license to commercialize, for which the company could not avoid fair payment in the form of royalties or sublicense fees. Moreover, the court found that the same contracts gave the foundation an ownership interest in the compounds as well as the patented discovery. *This decision shows how important the exact language of contracts can be in resolving disputes, even allowing parties to avoid the application of certain statutory laws. Nonprofits need to protect their interests in the intellectual property they develop.*

Other Issues, Trends & Developments

CHEQUE MATE: PONDERING END OF PAPER PAYMENTS IN U.K. – The Payments Council Board, an organization that regulates such matters in the U.K., has recently decreed that all of its member banks will end check clearing (or cheque clearing, as the Brits say) October 31, 2018. The Council notes that use of paper payments in the U.K. has declined in favor of electronic payments (as it has in the U.S.), and the Council prefers "managing the decline" instead of "leaving it to market forces," which would risk "increasing confusion among users, and increasing disadvantage for those who remain dependent upon cheques and are least equipped to change." While abolishing cheques, the Council says that existing alternatives to paper payments will be "promoted and explained" and, "where innovation and new options are required," they will be "put in place." *At the risk of being put in our place, we ask, what does this development mean for the U.S., and especially for nonprofits, which may still be in the Dark Ages, receiving checks for contributions, dues and other payments? Are nonprofits among those said to be "confused," "disadvantaged," "dependent" and "least equipped," especially here in the U.S., where some people still rely on those troublesome "market forces?" Can we defy those who would cut check (or cheque) processing costs for banks, regardless of how convenient paper payments can sometimes be for bank customers? Probably not. Better just prepare to succumb to "progress."*

H & H Developments

In February …

Samuel Erkonen presented "Managing Risk in the World of Social Media" in Las Vegas to a national association of home builders. He also presented two sessions in Washington, DC to a large event for meeting professionals entitled, "An hour of prevention: tips for avoiding litigation," including topics related to contracts, internal controls, employee issues, intellectual property as well as new concerns arising from the use of social networks and related media.

Barbara Dunn presented three sessions: "Web 2.0 Legal Issues Preview Session," "Web 2.0 Legal Issues and Lawyer's Debate," and "Web 2.0 Legal Issues" with another colleague at a major event for meeting professionals in Cancun.

Naomi Angel presented "Avoiding Legal Pitfalls – Managing Risk!" for an association in the building industry specific to its legal pitfalls at its annual meeting in Orlando, Florida.

Contributors to this issue ...

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