TO TERRY B. OR CAROLYN L.

Law Office Reprot #40 July 17, 1978 from June page 1

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Regarding the FCC inquiry, considering Walter's previous letter to FCC, cpy attached, she suggested first we check with Walter to see if it makes any difference in re FOIA if Tom;s license is in his name, not in P.T. in other words, on whose behalf do we write, Tom as an individual, or Tom working with P.T.
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B4d(7)

Note:
Debbie B.
affidavit, #7

7. Debbie B. affidavit - attached is affidavit, reported by Dr. Dr. Bedford as told to him by LA member to have been passed out in a CR meeting by Dr. White last week. This is only part of the packet; Marthat may be sending the full packet - Tom was xeroxing it and put it under her door and she is gone to Pete's place right now - we dont know if she will get back in time for reports. The rest of the packet consists of the Examiner article with her picture, Yolanda Crawford's old affidavit from the CR petition, and stuff that was attached to the Cobb and the Katsaris suit as exhibits, the pass out material that CR puts out. The affidavit of Debbie is the new stuff, and I am sending you 3 copies.

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B4d(28)

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(by us)

If we do get court permission, it wont be Charles who will do it because he just wont do that sort of thing; we would have to get an outside attorney to do it. That might not be so difficult, Clarence Wilridge has been helpful, but it will take more time and money. The guardianship is of the person and estate, which means that sooner or later an accounting will have to be filed on the estate; but there is no estate since no welfare benefits were ever collected by Rosanna. Chaikin is no longer attorney of record.

B 4a(25)

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B4d(32)

Coldwell Banker
COMMERCIAL BROKERAGE COMPANY

July 6, 1978

Mr. Jim McElvane
Peoples Temple of Disciples of Christ
Suite 235
3840 Crenshaw Boulevard
Los Angeles, California 90008

RE: Peoples Temple
1859 Geary Blvd
San Francisco, CA

Dear Mr. McElvane:

I welcomed the opportunity to meet with you yesterday and to inspect the subject property. Based on considerations given below, I would suggest listing it for sale at $225,000.

In evaluating the property, I have estimated that there is about 18,000 square feet of useable space and that a reasonable monthly rent would be in the order of 15¢ per square foot net of any operating expenses. This would provide an annual rent of $32,400. Normally, this income would be capitalized at 8.5 - 9.5% to give a value range of $340,000 - $380,000. This rate of return to an investor-user applies to such general purpose properties as office buildings, commercial stores, and warehouses. Also required are long-term leases of at least five years and tenants with sound financial statements. Because of the special purpose nature and age of your building, the short-term lease which you contemplate, and perhaps a relatively weak financial statement, a sale/leaseback in your situation would be highly speculative for an investor-buyer and would require a considerable higher return of around 15%. A 15% return would equate to a capitalized value of $216,000 for the property. If it sold for this amount, the 5% sales commission would be $10,800. I would recommend offering the property at $225,000 with Peoples Temple remaining as a tenant for a specified time with one or more renewal options and at a monthly net rent of $2700.00. The suggested listing price of $225,000 compares with the 1977-1978 assessed valuation of $194,500.

To meet your immediate cash needs, have you considered the alternative of obtaining a loan on the property and retaining title to it? Also, because of the special purpose aspects, your interests might be best served by listing the property on an open basis rather than with an exclusive agent like Coldwell Banker. This would certainly encourage activity by a wider number of brokers, particularly those who may be more familiar with the immediate area and better qualified than Coldwell Banker to produce a buyer in this case. On an open listing basis, the broker representing the buyer would collect the full 5% commission rather than only 2.5% if there were an exclusive agent of the seller's.

B4d(33)

These are my thoughts on the matter. I look forward to discussing this with you further and having the benefit of your comments.

Sincerely yours,

COLDWELL BANKER
COMMERCIAL BROKERAGE COMPANY

Fred Johnson

Frederick O. Johnson
(415) 772-0228

B4d (34)

Public Utilities Commission

STATE OF CALIFORNIA
TRANSPORTATION DIVISION—TARIFF AND LICENSE BRANCH
SAN FRANCISCO, CALIF.

IF YOU TELEPHONE, CALL 557-1909 (AREA CODE 415)

LEONS TRUCKING
Leon Perry
P.O. Box 466
Redwood Valley, CA 95470

File T- 86061
Dec. No. No Fund
Date 7-3-78

SUBJECT: Your report of GROSS OPERATING REVENUE for the 2nd quarter of 1978

☒ Report received without remittance of:

RATE FUND FEES		UNIFORM BUSINESS LICENSE TAX	
3/10 of 1% of $	No Operation	1/10 of 1% of $	No Operation
Quarterly fee	10.00	Penalty	
Penalty			
TOTAL	$ 10.00	TOTAL	$

TOTAL DUE $ 10.00

☐ Report received with incomplete information:

(a) Amount of Gross Operating Revenue . $_____ (State exact amounts)

(b) Amount of Subhaul Revenue . . . . $_____

(c) _____

(d) _____

☐ Signature on report indicated change in status of your operations

PLEASE NOTE: As long as the Highway Contract Carrier Permit remains in your name in active status, the liability for the quarterly fee will continue.

PLEASE NOTE:
Quarterly Fee due whether operations conducted or not
Quarterly Fee due during Suspension period
Quarterly Fee NOT paid by principal carriers

PUBLIC UTILITIES COMMISSION

By James K. Gibson
JAMES K. GIBSON, DIRECTOR
TRANSPORTATION DIVISION

Reply: _____

Date _____ [SIGNED] _____

TL 659 (REV. 8-77)

B42(35)

SHEARSON

Shearson Hayden Stone Inc
767 Fifth Avenue
New York NY 10022

See reverse for important inform

Client Statement

MR EUGENE B. CHAIKIN
PO BOX 15156
SAN FRANCISCO CA 94115

Account Date			
Account No	I.E. No	Page
083 15947	243	1

Social Security/ID No
566 40 0602

Investment Executive Name
CONRAD HAYTHORNE

Balance Summary	
Combined Account Opening Balance	Combined Account Closing Balance
.00	.00
Short Account Opening Balance	Short Account Closing Balance
.00	.00
Priced Portfolio Value	Buying Power
125.09	

Statement Date/Interest	
Statement/Interest Period	
05/27 - 06/30/78	
Interest Rate	Interest Charge
Average Daily Balance	

Earnings Summ
Dividend YTD
Bond Interest YTD
Municipal Interest Y

Date	Bought Rec'd or Long	Sold Del'd or Short	Description	Type	Price or Entry	Amount Charged	Amount Credited
	7		PORTFOLIO SUMMARY MARINERS FINANCIAL CORP	18	17.87		

SUPPORT REDUCTION OF CAPITAL GAINS TAX. READ ENCLOSED POLLACK LETTER. TELL YOUR CONGRESSMAN YOU ARE BEHIND STEIGER OR JONES PROPOSALS. WRITE WASHINGTON NOW.

B4d(36)

June 7 1978

The People's Temple
Box 15156
San Francisco
Ca 94115

Dear Sir

I have not received a reply to my letter of April 29 1978 regarding the $432.72 suit I have had to pay with respect to Brian Davis.

Regarding child support I now attach a schedule showing the amount of $8625.00 due me as of June 30 1978. Also enclosed again is a copy of the "Stipulation and Settlement Agreemnet".

I have consulted with the District Attorney and he has told me that this non-payment is a very serious matter and one to be pursued with Mr Davis immediately upon his return to the U.S.

I will look forward to hearing from you with regard to your plans for the payment of this child support, and the $432.72 suit.

Truly

Marietta F Davis

Marietta F Davis
111 Arundel Road
Burlingame CA 94010

Copy . Mr Robert Davis, P O Box 893 Georgetown, Guyana, S America
. People's Temple P O Box 214 Ukiah Ca 95470
. District Attorney, Family Support Division,
Hall of Justice, Redwood City, Ca
Case No D-25698 ONO DP04

B 4 d (37)

FOLLOWING IS THE REPORT SENT OVER BY KRIS KICE WAY BACK BEFORE TERRY WENT OVERSEAS THIS LAST TIME. IT IS STILL RELEVANT AND SUMMARIZES THE SITUATION. ATTACHED TO THIS ARE COPIES OF OUTLINE OF WHO AND HOW MUCH AND HOW LONG IS INVOLVED. FLO - 7/18/78

TO: TERRY

FROM: CHRIS KICE

RE: TAXES

7-10 PEOPLE WERE EMPLOYED THRU THE SOCIAL SERVICE DEPT. AS 'CHORE SERVICE PROVIDERS' WORKING FOR 14 SENIORS AT 1029 GEARY. THE PROVIDER IS PAID BY SOCIAL SERVICE & NO TAX IS TAKEN OUT OF THE MONTHLY CHECK. THE PROVIDER IS RESPONSIBLE TO QUARTERLY PAY TAXES ON A "SELF EMPLOYED' STATUS. FAILING TO DO SO, INVOLVES A PENALTY.

SOME OF THE CASES STARTED IN SEPT. '76 OTHERS WERE ADDED LATER. THE LAST TWO CASES STARTED MAY '77. ONLY LOIS BREIDENBAUCH WORKING FOR VIRGINIA TAYLOR MADE OVER $500.00 IN '76 AND A TAX FORM WAS SUBMITTED FOR HER BY HAROLD CORDELL IN JAN. '77.

TISH HAD ALL THE INFO. TO PAY THE TAXES IN MARCH '77. ORIGINALLY, SHE SAID SHE KNEW THE LAW, THE TAXES COULD BE PAID YEARLY. LATER, SHE SAID ALL THE INFO. HAD BEEN SENT OVER. FINALLY, SHE GAVE ME THE FOLDERS & SAID SHE WASL EAVING, TURN IT OVER TO HAROLD. I CONSULTED CHAIKAN A FEW MONTHS AGO ABOUT THIS. HE FFLT THA PERHAPS WE COULD AVOID PAYING TAXES FOR SENIORS WHO HAD LEFT.

IN SOME CASES THE SENIOR(RECIPIENT) & THE PROVIDER HAVE LEFT. IN OTHER CASES, THE SENIOR IS GONE BUT THE PROVIDER IS STILL HERE & PRESENTLY WORKING FOR THE OTHER SENIORS STILL HERE.THE FIVE ACTIVE CASES ARE:

JUDY MERRIAM WORKING FOR EDDIE JEWEL RUNNELS'

LOIS BREIDENBAUCH WORKING FOR RUBY JOHNSON: ARMELLA TARDY FORMERLY WORKED FOR RUBY, LEFT IN AUG.

TEENA TURNER WORKING FOR LAVANA JAMES: MAGDALEEN LYLES FORMERLY WORKED FOR HER, LEFT IN AUG.

ANDY SILVERS WORKING FOR JOE HELLE: RAY JONES FORMERLY WORKED. LEFT IN JUNE

JUDY MERRIAM WORKING FOR VIOLA GADSHALK: JUANITA BOGUE FORMERLY WORKED, LEFT IN AUG.

IN THE CASES OF LOIS, JUDY & TEENA, THEY ALSO FORMERLY WORKED FOR SENIORS WHO HAVE LEFT.

JUDY: WORKED FOR MAE K. GRIFFITH, LEFT AUG.

LOIS (ROCKI) : WORKED FOR VIRGINIA TAYLOR, LEFT AUG.

TEENA: WORKED FOR IRENE MASON & LOVE LIFE LOWE, BOTH LEFT IN AUG.

TGE ABOVE DATES "LEFT IN ____" ARE 1977.

B4d (38)

Lois [illegible]
Virginia Taylor 8/26/76 - 8/2/77
Betty Johnson 8/19/77 - 10/20/77

Tena Turner
Laverne Jones 8/20/77 -
[illegible] 4/2/77 - 8/19/77
Love Life Lowe 1/4/77 - 8/4/77

Vicky Marshall
Henry Mercer 12/1/76 - 8/10/77
Mildred Cozzell 11/26/76 - 8/10/77

Clara McKenzie
[illegible] 12/5/76 - 4/1/77
Julie [illegible] 12/20/76 - 8/10/77
Mary [illegible] 3/24/77 - 8/10/77

Magdalene Lyles
Laverne [illegible] 3/1/77 - 8/20/77

[illegible]
[illegible] 10/13/77 - 6/77

B4a(39)

Elsie Ross 8/20/76 – 7/1/77

Vera Goldsick 11/15/76 – 8/15/77

Ruby Johnson – handled our case

Elsie Ross 7/1/77 – 8/2/77

Eddie Jewel Connelly 10/6/76 –

Vera Goldsick – 8/15/77 –

Mae K. Griffith 12/1/76 – 8/11/77

6/77 –

approx. $ / month

Rose Eschenbauch [?]
Virginia Taylor $649.60

Terri Turner
[illegible] Mason $565.12
Love Life $180.21

[illegible] Marshall
Henry Mercer $391.50
Mildred Cureal [?] $391.50

Clark McKenzie
[illegible] $243.60
Mary Coleman $199.80

Magdalen Lytle
Louise [illegible] $233.80

[illegible]
Joseph [illegible] $519 [illegible]

[illegible]
[illegible]

[illegible]
[illegible]

B4d(40)

Armella Tacy

Ruby Johnson $46.80

Judy Mercurio

Jack Russell $391.50

Mae Griffith $391.50

$ 4,983.03

Client: Mae Griffith
1029 Geary #24 SF 94109
SS# 570-19-9055
D.O.B. 12-26-41
Case # 38-20-886592
unit # W466
Worker Helen Gibson 558-5495

attendant ~~Shirley~~ Judy Merriam
1951 Revere St. SF 94124
SS# 280-36-9440
D.C.S.

started work 12/1/76 pay period 17th of mo.
~~31.5 hrs/wk~~ @ $2.50 = 341.00
raise 1/1/76
same hrs. @ $2.40 = 404.55

employment ended 8/11/77

B4d(41)

Client Viola [illegible]
1029 Geary #28
SF 94109

attendant Judy [illegible]

employment started 2/15/77 [illegible] 14-
[illegible] hrs/wk @ $ [illegible]/hr.

B4d (42)

Client Eddie Jewel Runnels
1029 G. # 24
SS# 461-66-8583
D.O.B. July 23/34
Case # 38-583017
unit # W466
worker Helen Gibson 558-5495

attendant Judy Merriam
1951 Revere St. SF (24)
SS# 281-36-9446

Started Oct. 6 1976 Pay Period 6th. day of
31.5 hr./wk. @ $2.50 = $341.-
raise 1/1/77
Some hrs. @ $2.90 =

B4 d (43)

Client Irene Mast

1029 G #58

SS# 421-24-4439

D.O.B. 11-15-95

Case # 38-20-887901

Unit # 466

Worker Helen Gibson

Attendant Clara McKenzie

272 Herman

SS# 563-38-7939

D.O.B. 11-26-29

Started Dec. 5 '96 — pay period 1st time

44 hr/wk @ $2.50 = $176.00

Raise 1/1/96

Same hrs @ $2.90

employment ended April 1 '97

replaced by Tena Tucker

RHA (44)

Client Julia Birkley

add: 1029 Geary #28 SF 94109

SS# 187-09-0441

D.O.B. 7-25-89

attendant Clara McKenzie

272 Herman phone 863-1658

SS# 563-38-7739

D.O.B. 11-24-29

Julia's case # 10-88?229

unit # W424

worker Sandra Gonzalva 558-2311

started work 12/1/76 Pay period 8th of mo.

21 hrs/wk @ 2.50/hr = $227

raise to 2.90/hr. effective 1/1/77

change in hrs. 4/18/77

16 hrs/wk @ 2.90/hr.

employment ended 8/10/77

B4d (45)

Client

Mary Coleman
1029 Geary # 28
SF 94109
Case # 834423
worker S. Grijalva

attendant

Ilene McKenzie
272 Herman
SS# 563 38- 7739
D.O.B. 11-26-29

employment started: 3/24/77 orig plan 7th. 17 mos.
15½ hrs./wk. @ $2.46/HR.
employment ended: 8/10/77

84d (46)

Client Henry Mercer
1029 G. #38
SS# # 199-03-9917
D.O.B. 4/03/1902
Case # 38-20-887155
Unit # W466
Worker Helen Gibson 558-5495

attendent Vicky Marshall
1029 G. #85
SS# 542-04-8957

started Dec 1 '96
3.5 hrs/wk @ $2.50 = $341.00/mo.
raise 1/1/97
same hrs @ $2.91 = $365.40

employment ended 8/17/97

pay period 14th of month

B 4d (47)

Client: Mildred Carroll
1029 Geary #38 SF 94109
SS# 149-05-5790
D.O.B. 02-19-1899
Case # 38-20-887408
unit # W466
worker Helen Gibson 558-5475

attendant: Vicky Marshall
1029 Geary # 65 771-9869
SS# 562-04-8957
D.O.B.

started work 11/26/96
31.5 hrs/wk @ 250/hr. = $341/mo.
raise 4/1/97
same hours @ 2.90/hr. = $404.55

employment ended 8/16/97

pay period 3rd. of month

B4d (48)

Client: Lavana James
1209 Geary #52
SF 94109
SS#
DOB
Case # 895472
worker M. Snyder W472

Attendant: Tiena Turner
620 Buchanan
SS# 566-02-7966
D.O.B 12/15/55

Employment started: 8/22/77
20 hrs/wk. @ $2.45/HR.
Employment ended:

Tiena replaced Magdalena Lyle

B4d(49)

Client Irene Mason

Same info. see other sheet on Irene

Attendant Teena Turner
620 Buchanan
SS# 566-02-7966
D.O.B. 12/15/55

Started April 2 1997
44 hrs /wk @ $2.90

Employment ended 8/19/97

pay period 1st. of mo.

B4d (50)

Client Love Life Lowe

1029 G. # 12

SS# 088-42-5801 A

D.B. 12/2/1888

Cal # 38-10-888227

Unit # W424

Worker - Mr. Tinkler 558-2311

Attendant Juena Turner

620 Buchanan St. SF 94102

SS# 566-02-7966

D.B. 12/15/55

Started work 7/1/77

15 hrs./wk. @ $2.90

employment ended 8/4/77

pay period 8th. of month

B4d (51)

Med Ruby Johnson
1029 Geary #8
SF 94109
SS#
D.o.B.
Case # 895066
Unit # XR 14
worker: Herbert Warner

Attendant Lois Breidenbach
Started: 8/19/77
38 hrs/wk @ 2.90 HR.
ended: 10/20/77

Lois replaced Armella Tandy

B401(52)

Client Virginia Taylor
1029 G. #22
221-3414
SS# 205-12-2261A
DoB 9/29/98
Case # 818751
Unit # GW 4613
Worker Elizabeth Prosser 558-2702

Attendant Lois Breidenbauch
1029 G. #9
SS# 569-76-5442
DoB

Started work Aug. 20 '96 @ $292.00/mo.
Oct. 15 raise to: $548.00/mo
56 hrs/wk @ $2.50/hr.
7/1/97 raise to: same hrs. @ $2.90/hr.
employment ended 8/2/97

pay period 14th of mo.

B4d (53)

Client Elaie Ross
1129 Geary #22
SF 94109
SS# 466-12-6011-A
DOB 12-10-89
Case# 38-894613
und # 094613

attendant: Nena Downs ~~[illegible]~~
865 Fillmore
SF

Employment Started: July 6, 1977
15 hrs/wk. @ $2.92 /hr.
Employment ended: 8/2/77
pay period 5th of mo.

B4d (54)

Client Elsie Ross

1029 G. #22

991-3414

SS# 466-12-6011 A

D.O.B. 10-10-89

Case # 38-874613

Unit # W4613

Worker Elizbeth Prosser 558-2702

attendant Christine Kee

1029 G. #B5

SS# 386-48-0319

D.O.B. 2/28/50

Started work ~~Sept~~ Aug. 26 1976 — pay period 5th

15 hrs. /wk @ $2.50 = $130.00/mo

raise 7/1/77

Same hrs @ $2.90 = $150.80/mo

employment terminated July 6, 1977

~~Hired~~ Replaced by Nick Dennis

841(55)

Client Viola Goldsall
1029 G. #49
SS# 554-14-5160
DOB 2/10/21
Case # 884452
Unit # 0454
Worker Mrs. Spira 558-2116 or 2118

Attendant Juanita Roque
2231 Sutter
SS# 564-35-7841

Started Nov. 15th '76 pay period 14th of mo.
20 hrs/wk @ $2.50 = $220.00/mo
raise 1/1/77
Same hrs @ $2.90
employment terminated 1/15/77

replaced by Judy Merriam

B4d56)

Client Ruby Johnson

1029 Geary #8

S.F. 94109

D.O.B.

Case #

Unit #

Worker Herbert Wilcox

Attendant: Armella Tardy

1029 Geary #8

SS #

Employment Started: Info will have to be obtained from Ruby or Armella

Employment ended: 8/15/77

Replaced by Rocky Breidenbach

B4A(57)

Client: Lavana James
1029 Geary #52
SF 94109
Case # 895472
Worker M. Snyder W#32

attendant Magdalen Lyles

employment started: 3/1/77
20 hrs./wk. @ $2.90/hr.
" ended: 8/20/77

Replaced by Tena Turner

B4d (58)

Client Joseph Hall
1029 G. # 25
SS# 552-74-9050
D.O.B. 6/6/50
Case # 38-60-882094
unit # W499
Worker Herbert Weiner 558-5934

attendant Ray Jones
1029 G. # 61
SS# 402-52-8880
D.O.B.

Date started 10/13/76 Pay period 25th of month
35 hrs/wk @ $2.50/hr. = $379.00/mo
Case 1/1/77 same hrs @ $2.90.

employment ended June '77

Ray was replaced by Andy Silveira

B4d (1-59)

To Terry Buford or Carolyn Layton

These are excerpts from a publication which has been circulating around my office this week - very relavent to questions re nonprofit corps, unrelated business income, taxation of churches, etc.

I am sending 2 sets; 1 set will remain here for our reference.

from June
7/18/78

B4d(60)

Excerpts from

1978 TAX EXEMPT ORGANIZATIONS CONFERENCE

July 6, 1978 - San Francisco
July 7, 1978 - Los Angeles

by

California Certified Public Accountants
Foundation for Education and Research

1000 Welch Road, Palo Alto, California 94304

B4d (61)

RECENT REGULATORY DEVELOPMENTS
Churches

Adrian G. Player

This topic on churches has been provided because of the serious issues involved with religious organizations claiming to be a church under IRC Sec. 170(b)(1)(A)(i). The materials include the problems of definition; inurement to memebers; unrelated business income tax issues; the sensitive area of mail order ministries, assignment of income and vow of poverty; the use of IRC Sec. 501(c)(3) organizations as conduits for nonexempt purposes; and procedures under IRC Sec. 7605(c) for initiating the audit of an organization claiming to be a church.

I. Church Definitional Problems:

The Internal Revenue Code mentions in no less than fifteen different places such words as "church," "religious order," "religious purposes," etc. (See "'Church' in the Internal Revenue Code: The Definitional Problems" by Charles M. Whelan, Fordham Law Review, Vol. 45, March 1977.) Interpreting this statutory language has placed the Service in the position of defining terms that have been debated by philosophers for centuries. The Congress has given the IRS no guidance in this area. The courts, while they have generally avoided the issue, have given some help. In De La Salle Institute v. U.S., 195 F. Supp. 891, 903 (N.D. Cal., 1961), IRS was told to "leave the definition to the common meaning and usage of the word." In Chapman v. Comm., 48 TC 358 (1967) the Tax Court added to this concept by declaring that Congress used "church" more in the sense of a denomination or sect than in a generic or universal sense. Most helpful, perhaps, was the Supreme Court in United States v. Seeger, 380 U.S. 163 (1965) where the Court stated that a sincere and meaningful belief that occupies a place in the lives of its possessors parallel to that filled by orthodox beliefs in God is, in effect, a religious belief.

The National Office of the IRS has wrestled with these definitions and has adopted a ruling position based on historical and practical considerations in arriving at what the Court in De La Salle called "the common meaning and usage" of the word "church." In doing so the Service has attempted to distill from authoritative judicial sources those indicia of the existence of a church that are the most objective and least involved with particular beliefs, creeds or practices. But beliefs and practices vary so widely that the IRS has been unable to

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formulate a single definition. The determination of whether a particular organization is a church must, therefore, be made on a case-by-case basis. The characteristics to be utilized are:

A. A distinct legal existence.

B. A recognized creed and form of worship.

C. A definite and distinct ecclesiastical government.

D. A formal code of doctrine and discipline.

E. A distinct religious history.

F. A membership not associated with any other church or denomination.

G. A complete organization of ordained ministers ministering to their congregations.

H. Ordained ministers selected after completing prescribed courses of study.

I. A literature of its own.

J. Established places of worship.

K. Regular congregations.

L. Regular religious services.

M. Sunday schools for the religious instruction of the young.

N. Schools for the preparation of its ministers.

Because few, if any, religious organizations, conventional or unconventional, could satisfy all of these criteria, controlling weight should not be given to any single factor. The final decision thus must be based on all of the facts and circumstances of each case.

In addition, it must also be kept in mind that any organization claiming exemption by church status is also subject to the tests for the use of the profits of the organization and the exclusive purposes of its existence. Also, the organization must conform to all of the basic principles of charity law to qualify for recognition of exemption under IRC Sec. 501(c)(3) that are applied to other organizations claiming exempt status under IRC Sec. 501(c)(3).

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II. Church Inurement Issues.

The issue of inurement with respect to an organization claiming to be a church is complicated by the fact that the organization ordinarily pays salaries to its ministers and in many cases pays their personal and living expenses. Rent-free houses are often provided, as well as all expenses arising from the use of the residence, including heat, electricity, real estate taxes, water, repairs and maintenance. The organization may provide its "ministers" with unlimited use of an automoblie, and pay all expenses arising from its use, including gasoline and oil, repairs and insurance. It may also pay insurance premiums on the lives of its members and provide food to the minister and his family.

Churches have historically provided living quarters and paid the other general living expenses of their ministers and their families. The Service has ruled that a church compensating its ministers in this manner does not necessarily preclude it from being recognized as exempt under IRC Sec. 501(c)(3). However, the situation frequently arises in the mail order ministry cases that the ministers receiving payments for their living expenses have the ability to control the actions of the organization. An organization is not precluded from establishing its exempt status under IRC Sec. 501(c)(3) merely because it is controlled by one individual. Rev. Rul. 66-219, 1966-2 CB 208. However, in this type of situation it is difficult to ascertain whether or not the payments made to the ministers are excessive, since the elements of an arm's-length transaction are not present.

Generally, where an organization purchases assets (or services) from an independent third party, a presumption exists that the purchase price represents fair market value. However, where the purchase is controlled by the seller (or where there is a close relationship between the two) at the time of the sale, this presumption cannot be made because the elements of an arm's-length transaction are not present. Rev. Rul. 76-91, 1976-1 CB 149.

The difficulty of applying arm's-length standards resulted in the enactment of IRC Sec. 4941, which prohibits certain acts of self-dealing between a private foundation and disqualified persons and which provides for a progressive series of excise tax sanctions against the self-dealer and the foundation manager who wilfully engage in them. Although IRC Sec. 4941 applies only to private foundations and hence not to churches, the self-dealing analogy may be useful in determining which transactions

B 4d (64)

between the organization and one or more insiders requires more thorough investigation.

Regs. 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. In order to determine the situations to which this standard applies, it is necessary to determine the meaning of the terms "private shareholder or individual" and "net earnings."

The term "private shareholder or individual" is defined in Regs. 1.501-(a)-1(c) as referring to persons having a personal or private interest in the activities of the organization. In Lewis et al. v. U.S., 61-1 USTC para. 9231 (D. Wyo. 1961) the court held that trust income did not inure to the benefit of a private "shareholder or individual" under IRC Sec. 501(c)(3) where the trustees of a foundation established as a testamentary trust were directed by the terms of the will to pay $50 a month to the testator's grandniece, since the grandniece has no personal or private interest in the activities of the foundation. From the definition of "private shareholder or individual," the prohibition against inurement of net earnings in IRC Sec. 501(c)(3) is aimed at preventing persons in a position to deal with the exempt organization from diverting the organization's net earnings to their own private benefit. In the mail order church context, the term "private shareholder or individual" would include the officers and ministers of the church.

The term "net earnings" in the accounting context is defined as the excess of receipts over expenses. However, for purposes of determining whether an organization is exempt under IRC Sec. 501(c)(3), it is well established that an organization's net earnings may inure to the benefit of private individuals in ways other than by the actual distribution of dividends from the net profits as reflected on the organization's books. Courts commonly find inurement in the form of payments which are too excessive to constitute legitimate expenses. The fact that the regulations define "private shareholder or individual" as "persons having a personal or private interest in the activities of the organization" supports the view that the phrase "net earnings" was intended to distinguish between legitimate expenses of the organization and distributions which divert profits for such persons.

Also, IRC Sec 501(c)(3) provides that no part of the net earnings may inure to the benefit of any private shareholder or individual. This has been interpreted as

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meaning that there is no de minimis exception to the rule proscribing inurement. Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (E.D. Wash., 1963). See also Rev. Rul. 67-251, 1967-2 CB 196.

Whether or not certain payments by a church have inured to the benefit of "any private shareholder or individual" is a question of fact rather than law. There is no classification of certain types of payments which may be said to constitute inurement per se.

The burden of proof as to whether or not payments for living expenses are too excessive to constitute legitimate expenses is on the organization claiming exemption. The Founding Church of Scientology v. U.S., 412 F. 2d 1197 (Ct. Cl. 1969), held that an organization had failed to meet its burden of proof that net earnings did not inure to the benefit of private individuals where the organization provided an automobile and a personal residence for its founder, L. Ron Hubbard, as well as providing loans to members of Hubbard's family. Hubbard also received income from the organization in the form of royalties and commissions. Similarly, Rueckwald Foundation, Inc. v. Comm., 33 TCM 1383 (1974), held that the organization had not demonstrated that its net earnings had not inured to the benefit of private individuals where the organization defrayed its founder's personal expenses for maintaining his home and paid other personal and family expenses of its founder, including insurance expenses, college expenses, and the nursing home and medical expenses of the founder's mother. A factor weighing in favor of a finding of inurement was that the founder of the organization was the sole arbiter of the amounts to be paid, and the amounts paid were determined by the needs of the beneficiaries and the availability of funds. The Service has ruled that an organization paying the personal living expenses of persons affiliated with the organization should be required to demonstrate that the payment of such expenses is determined by reference to the fair market value of their services or the fair market value of facilities provided to the organization by them.

In determining whether compensation paid by the organization is reasonable, courts have judged by determining whether the compensation would be reasonable under Sec. 162 of the Code if a nonexempt organization had paid it. Enterprise Railway Equipment Company v. U.S., 161 F. Supp. 590 (CT Cl. 1958).

It is quite common in "mail order" ministries that an individual founder of an organization claiming church status frequently obtains minister's credentials and

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a church charter by mail for a fee from an organization that may or may not be exempt under IRC Sec. 501(c)(3). The individual then takes a vow of poverty and assigns his assets and income to the church he has established. A major portion of the income assigned to the church is used for the personal living expenses of the individual. Only a relatively small portion of the income is spent for charitable purposes.

Although Rev. Rul. 69-266, 1969-1 CB 151 does not involve the inurement issue, it may be applied in denying recognition of exemption under IRC Sec. 501(c)(3) to the mail order ministry situation. Thus, Rev. Rul. 69-266 is applicable where an individual takes a vow of poverty and assigns his assets (i.e., house, car, etc.) and income to the church he has established, with the major portion of the income assigned used for the benefit of the individual creator and with only a relatively minor portion of the income assigned used for charitable purposes. Although the "church" is not engaging in a commercial operation for the benefit of its creator, as in Rev. Rul. 69-266, the following principle contained in Rev. Rul. 69-266 may be applied in denying recognition of exemption under IRC Sec. 501 (c)(3) of many mail order ministry-type churches:

> The organization is operated by its creator essentially as an attempt to reduce his personal federal income tax liability while still enjoying the benefit of his earnings. Thus, the organization's primary function is to serve the private interest of its creator rather than a public interest.

When the facts indicate that the creator operates his established church primarily for the purpose of reducing his personal federal income tax liability recognition of exemption under IRC Sec. 501(c)(3) should be denied. For example, when an individual is a full-time employee of a third party organization, and transfers his income and assets under a vow of poverty to the church he has created, with the major portion of the income assigned used for the benefit of the individual creator and with only a minor portion of the income and the individual's time devoted to church activities, it would appear that denial of exemption under Rev. Rul. 69-266 is warranted. In this situation, the church established by the individual is merely a shell utilized primarily for the purpose of reducing its creator's tax liability.

III. Unrelated Business Income Tax.

Ordinarily, IRC Sec. 512(b)(12) permits an exempt organization to take only one specific deduction of no more

than $1,000 in computing its unrelated business taxable income. A church that is one organization is permitted by IRC Sec. 512(b)(12) to take a specific deduction of no more than $1,000 for each parish, individual church, district or other local unit having unrelated business taxable income.

A question was raised whether a church that is one organization, with local units, must report all of its unrelated business taxable income on one Form 990-T in situations where the organization qualifies for multiple IRC Sec. 512(b)(12) deductions. One church suggested that in such situations it was intended that a separate Form 990-T be permitted to be filed for each local unit qualifying for a specific deduction.

The Service has concluded that IRC Sec. 512(b)(12) does not affect the filing requirements under IRC Sec. 6012 for reporting unrelated business taxable income. Therefore:

A. A church that is one legal entity with various local units must report all of the UBI of the church and its local units on one Form 990-T. (IRC Sec. 512(b)(12) does not authorize a separate Form 990-T to be filed by each local unit.)

B. Local units of a church organization that constitute separate legal entities must each file a separate Form 990-T.

The UBI tax on churches generated three significant ruling requests that are now being finalized in the national office. In these requests for non-taxation under IRC Sec. 511, the churches claim relatedness of their business activities to their exempt functions.

In one case a group of independently incorporated monasteries carries on businesses through the labors of their monks. They argue that their business activities are substantially related within the meaning of IRC Sec. 513(a) because of their longstanding religious belief and practice that manual labor is a necessary part of religious life. The monasteries argue that their business activities are selected and operated in a manner that is compatible with a monastic way of life and a rigorous daily routine of worship, work and private prayer or reading. While the IRS does not question the sincerity of the belief that manual labor is an essential element of monastery life, they are considering whether such a belief establishes "relatedness."

Among the monasteries there was a wide range of business activities including the following categories and examples:

1. Religious goods (incense, stained glass windows)

2. Unprocessed food products (beef cattle, grain, timber)

3. Processed food products (bread, cheese, fruitcakes)

4. Miscellaneous manufactures (concrete blocks, furpiture)

5. Monastery giftshops (religious articles, cheese, candy)

Religious goods (category 1) and some giftshop sales (category 5) will clearly be able to meet the IRC Sec. 513 relatedness test. The Senate report on the TRA '69 is specific in stating that unrelated business income does not include the sale of religious articles as long as such an activity is carried on in connection with the church. S. Rep. No. 91-552, 91st Cong., 1st Sess. 70 (1969). The Service's interpretation of the committee report and its conclusion under IRC Sec. 513 is that the production of certain goods has some special religious significance to the church that produces them. Note, however, that relatedness is not automatically established merely because the goods in question are somehow "religious" in nature. For example, if one of the business activities at issue for a Catholic organization is the making of vestments, then to the extent that the vestments are for use anywhere in the Catholic church, their production is a related activity. If the production of vestments is for other denominations, the activity would not bear a causal relationship to the exempt functions of the Catholic organization.

In another case a church operated a laundry and broom factory through both full-time employees and part-time student employees of its religious schools. Relatedness was claimed on the basis of the church's belief that daily work of whatever kind is a vocation or a calling and that by doing one's work with fidelity, integrity and diligence, a person is truly serving God.

In a third case a church carried on farming, processing and manufacturing activities using both paid and voluntary labor. The church claimed that its business activities were related in that they are designed:

1. To develop the capacity to render immediate basic commodity relief to the needy,

2. To secure the long term capability to respond to large scale commodity needs which may arise from social or natural disturbances,

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3. To provide the means whereby needy recipients may work to the extent of their ability for the assistance they receive, and

4. To provide an opportunity whereby all members of the church may become directly involved in the charitable relief of their fellowmen.

For a plain language publication on the unrelated trade or business provisions, especially written for churches, refer to Pub. 1018, Tax on Unrelated Business Income of Churches. For more details, see Pub. 598, Tax on Unrelated Business Income of Exempt Organizations, and chapters (35)00 through (41) of the EOHB (IRM 7751).

IV. Mail Order Ministries: Assignment of Income, Vow of Poverty, IRC Deduction Problems.

Information on mail order ministries has been obtained from newspaper articles and publications circulated by the ministries. The information available indicates that these organizations are in the business of selling minister's credentials and church charters.

The publications state that a church may either file for tax exemption or use the tax exemption of another church for a small fee. According to those promoting mail order ministries, the tax code requires only that the members profess some common doctrine and hold meetings where some sacrament or ritual is performed. No particular doctrine is required in order to receive a church charter. Further, anyone will be ordained regardless of beliefs.

Purchasers of minister's credentials and church charters are informed that they may save up to 50% on their income taxes by taking the following steps:

a. Organize a church.

b. Contribute 50% of your taxable income to the church.

c. The church furnishes the minister tax-free benefits, such as housing, transportation, etc.

Purchasers are advised of an alternative plan whereby they may avoid all income tax. This plan calls for the individual to take a "vow of poverty" and to assign the individual's assets (house, car, savings account, etc.) and the income earned from the individual's current employment to the church. The assigned income is used for housing, food, clothing, etc., for the individual.

B 41 (70)

Since the individual receives benefits designed for his maintenance and comfort in return for his contribution, he is entitled to a charitable contribution deduction only to the extent that the amount turned over to the "church" is actually used for charitable and religious purposes.

With respect to the plan calling for an individual to take a "vow of poverty" and assign income to a church, Rev. Rul. 77-290, IRB 1977-33, 11, holds that an attorney, a member of a religious order, who has taken a vow of poverty and is instructed by the order's superiors to obtain employment with a law firm in the state is an agent of the employing firm, not the religious order, and must include the remuneration remitted to the order in gross income.

Thus, the assignment of income under the circumstances advocated by the mail order ministries does not enable an individual to legally avoid income tax.

Also, keep in mind the basic principle of federal income tax law that an assignment or similar transfer of compensation for personal services to another individual or entity is ineffectual to relieve the taxpayer of federal income tax liability on such compensation, regardless of the motivation behind the transfer. See Lucas v. Earl, 281 U.S. 111 (1930); Helvering v. Horst, 311 U.S. 112 (1940), 1940-2 CB 206; Helvering v. Eubank, 311 U.S. 122 (1940), 1940-2 CB 209.

Finally, the organization itself may not qualify for exemption under IRC Sec. 501(c)(3). See Rev. Rul. 69-266, previously discussed in Section II.

V. Procedures Under IRC Sec. 7605(c).

The Regional Commissioner's personal approval of the examination of a church is required by IRC Sec. 7605(c) (enacted in the Tax Reform Act of 1969).

The congressional explanation of the purpose of the requirement was to "protect churches from unnecessary tax audits in the interests of not interfering with the internal financial matters of churches."

The regulations expand the scope of the statute by requiring Regional Commissioner's approval of all examinations of churches for purposes of determining any tax rather than merely examinations related to unrelated trade or business income taxes. This probably reflects a judgment by those drafting the regulations that under the Service's "package audit" concept, it is not easy to distinguish in advance what kind of an examination is to be conducted.

B 4d (71)

The following procedures tend to slow down the examination of a purported church:

1. The necessity to issue and wait for responses to two pre-examination letters prior to requesting Regional Commissioner approval to examine.

2. The amount of time between the issuance of the pre-examination letter and the response date.

The Service has asked Chief Counsel to consider whether these procedures may be revised. Counsel has advised us informally that two pre-examination letters are necessary because the regulations require that reasonable "attempts" be made to obtain desired information. However, the IRS has been informed that the time between the issuance of the letter and the date on which we require the organization to respond to it may be reduced to 10 days. With respect to following pre-examination procedures in every instance that an organization claims to be a church, the IRS has been advised to follow the procedures whenever there is any arguable factual basis for making a claim of church status.

B 4 d(77)

IS YOUR INCOME TAXABLE?
(UNRELATED BUSINESS INCOME)

James R. Avedisian

I. Exempt organizations may be taxed on business income which is not related to their exempt function. Sec. 511(a)(1).

A. Almost all exempt organizations are subject to the tax on unrelated business income.

1. All exempt organizations listed in Sec. 501(c) are subject to the tax with the exception of U. S. instrumentalities described in Sec. 501(c)(1).

2. Qualified pension and profit-sharing plans described in Sec. 401(a) are subject to the tax.

3. Public colleges and universities are subject to the tax. Sec. 511(a)(2)(B).

a. The heading "state colleges and universities" is misleading.

b. A wholly owned corporation is also subject to the tax.

B. The tax rates are determined by the legal form of the organization.

1. A corporate organization pays the tax at corporate rates. Sec. 511(a)(1).

2. An organization which is a trust pays the tax at trust rates. Sec. 511(b).

C. Organizations subject to the tax on unrelated business income are also subject to the minimum tax for tax preference items which enter into unrelated business taxable income.

II. The tax is imposed on unrelated business taxable income.

A. Unrelated business taxable income is the gross income derived from any unrelated trade or business less allowable deductions.

B. Allowable deductions are those directly connected with carrying on the unrelated trade or business. Sec. 512(a)(1).

B4d(73)

C. There are statutory modifications to both income and deduction items. Sec. 512(b).

III. Unrelated business income is income from a trade or business, which is regularly carried on, and the conduct of which is not substantially related to the exempt function of the organization.

A. The activity must be a trade or business.

1. "Trade or business" has the same meaning it has in Sec. 162. Reg. 1.513-1(b).

2. A trade or business includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

3. An activity does not lose its identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may or may not be related to the exempt function of the organization. Sec. 513(c).

4. The requirement that the activity be a trade or business reflects the primary objective of the tax on unrelated business income - to eliminate a source of unfair competition.

B. The activity must be regularly carried on.

1. An activity will be considered to be regularly carried on if it has a frequency and continuity, and is pursued in a manner generally similar to comparable commercial activities of taxable entities. Reg. 1.513-1(c)(1).

2. The conduct of an activity for a few weeks is not considered regularly carried on if such activity is normally carried on year-round by taxable entities.

3. The conduct of an annual dance or similar fund raising event is not a trade or business regularly carried on. Reg. 1.513-1(c)(2)(iii).

C. The activity must not be substantially related to the exempt function of the organization.

1. The organization's use of income or its need for income does not cause an activity to be considered related to the organization's exempt function. Sec. 513(a).

B 4d (74)

2. To be substantially related to the exempt function of the organization, the production or distribution of goods or the performance of services must contribute importantly to the accomplishment of that function. Reg. 1.513-1(d)(2).

3. The size and extent of the activity must be considered in relation to the nature and extent of the exempt function it purports to serve. Reg. 1.513-1(d)(3).

4. Income from charges for the performance of an exempt function is not unrelated business income. Reg. 1.513-1(d)(4)(i).

5. Ordinarily income from the sale of products which result from the performance of an exempt function is not unrelated business income if the product is sold in substantially the same state it is in on completion of the exempt function. Reg. 1.513-1(d)(4)(ii).

6. There may be a dual use of assets or facilities, one use may be substantially related to the exempt function and another use may not. Reg. 1.513-1(d)(4)(iii).

7. If an exempt organization exploits its good will or other intangibles, the resultant income is unrelated business income unless such activity itself contributes importantly to the accomplishment of the organization's exempt function. Reg. 1.513-1(d)(4)(iv).

   a. Income from the sale of subscriptions to a monthly journal to members and others in accordance with the organization's exempt function is not unrelated business income. Reg. 1.513-1(d)(4) Example (6).

   b. Income from the regular sale of space for general consumer advertising is unrelated business income. Reg. 1.513-1(d)(4) Examples (6) and (7).

8. There are specific exceptions for certain activities.

   a. A trade or business in which substantially all the work is performed by unpaid volunteers is not an unrelated trade or business. Sec. 513(a)(1).

   b. A trade or business which is carried on by a Sec. 501(c)(3) organization or a public college or university primarily for the convenience of its members, students, patients, officers or employees is not an unrelated trade or business. Sec. 513(a)(2).

B 4 d (75)

c. Income from the sale by a local employees organization described in Sec. 501(c)(4) and organized before May 27, 1969 of work-related clothes and equipment and items normally sold through vending machines, etc., for the convenience of its members is not unrelated business income. Sec. 513(a)(2).

d. Income from the sale of merchandise substantially all of which has been received by the organization as gifts or contributions is not unrelated business income. Sec. 513(a)(3).

9. The Tax Reform Act of 1976 created new rules for certain activities of state fairs and trade shows.

a. Qualified public entertainment activities (as defined in Sec. 513(d)(2)(B)) conducted by a Sec. 501(c)(3), (4) or (5) organization which regularly conducts, as one of its substantial exempt purposes, an agricultural and educational fair or exposition are not an unrelated trade or business. Sec. 513(d)(1).

b. Qualified convention and trade show activities (as defined in Sec. 513(d)(3)(B)) conducted by a Sec. 501(c)(5) or (6) organization which regularly conducts, as one of its substantial exempt purposes, a show which stimulates interest in, and demand for, the products of a particular industry or segment of such industry are not an unrelated trade or business. Sec. 513(d)(1).

IV. Only deductions which are directly connected with the carrying on of an unrelated trade or business are allowable in computing unrelated business taxable income. Sec. 512(a)(1).

A. A deduction is directly connected with the conduct of unrelated business if it has proximate and primary relationship to the carrying on of that business. Reg. 1.512(a)-1(a).

B. Where facilities are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses, depreciation and similar items attributable to such facilities (as, for example, items of overhead), shall be allocated between the two uses on a reasonable basis.

C. Where an unrelated trade or business activity exploits an exempt activity, expenses, depreciation and similar items which are attributable to the exempt activity qualify as directly connected with the carrying on of the unrelated trade or business activity to the extent that

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1) the aggregate of such items exceeds the income (if any) derived from or attributable to the exempt activity; and

2) the allocation of such excess to the unrelated trade or business activity does not result in a loss from such unrelated trade or business activity.

D. Where the sale of advertising in a publication of an exempt organization is carried on in conjunction with an exempt function, the Regulations explain in detail the proper methods of calculating unrelated business income. Reg. 1.512(a)-1(f).

V. The Code spells out certain modifications of items of income and deduction. Sec. 512(b).

A. Dividends, interest, annuities, and royalties and all deductions directly connected with such income are excluded. Sec. 512(b)(1) and (2).

1. Dividends, interest and annuities from debt-financed property are included. Sec. 512(b)(4).

2. Interest and annuities received from 80 percent controlled organizations are included. Sec. 512(b)(13).

B. All rents from real property are excluded. Sec. 512(b)(3)(A)(i).

1. If personal property is rented along with real property, all rents are excluded if the rent attributable to the personal property is 10 percent or less of the total rent. Reg. 1.512(b)-1(c)(2)(ii)(b).

a. If more than 50 percent of the rent is attributable to the personal property, none of the rent is excluded. Sec. 512(b)(3)(B)(i).

b. If the rent attributable to the personal property is between 10 percent and 50 percent of the total rent, only the portion of the total rent attributable to the real property is excluded.

2. If the amount of rent is based upon income or profits derived from the property, none of the rent is excluded. Sec. 512(b)(3)(B)(ii).

C. With respect to each debt-financed property which is unrelated to the organization's exempt function, there is included a percentage of income and deductions. Sec. 514(a).

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1. The percentage is a ratio of average indebtedness to average adjusted basis.

2. Debt-financed property is property which is held to produce income and with respect to which there is an acquisition indebtedness. Sec. 514(b).

   a. There are special rules when land is acquired for exempt use within 10 years. Sec. 514(b)(3).

   b. Acquisition indebtedness is the unpaid balance of indebtedness incurred in acquiring or improving the property, or other indebtedness which would not have been incurred but for such acquisition or improvement. Sec. 514(c)(1).

      1) Property acquired subject to a mortgage is considered as having an acquisition indebtedness. Sec. 514(c)(2)(A).

      2) There are special rules where property subject to a mortgage is acquired by devise, bequest or gift. Sec. 514(c)(2)(B).

D. Gains and losses from the sale, exchange or other disposition of property are excluded. Sec. 512(b)(5).

   1. Gains and losses from the disposition of debt-financed property are not excluded. There is a special percentage calculation. Sec. 514(c)(7).

   2. Recapture provisions of Sec. 1245 and Sec. 1250 override this exclusion.

E. The net operating loss deduction is calculated by reference to only those amounts included in the calculation of unrelated business taxable income. Sec. 512(b)(6).

F. All income and deductions attributable to research for the government are excluded. Sec. 512(b)(7).

G. There is a specific deduction of $1,000. Sec. 512(b)(12).

VI. For social clubs and voluntary employees' beneficiary associations, unrelated business income is gross income less deductions directly connected with the production of gross income, less exempt function income and deductions. Sec. 512(a)(3)(A). Prop. Reg. 1.512(a)-3.

   A. Exempt function income is gross income from dues, fees and charges paid by members in furtherance of the organization's exempt purpose. Sec. 512(a)(3)(B). Rev. Proc. 71-17, 1971-1 C.B. 683.

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B. Amounts set aside for charitable purposes are considered exempt function income. Sec. 512(a)(3)(B)(i).

C. In the case of a voluntary employees' beneficiary organization amounts set aside to provide for payment of life, sick, accident and other benefits are considered exempt function income. Sec. 512(a)(3)(B)(ii).

VII. Homeowners associations are taxable only under specific provisions. Sec. 528.

A. Homeowners association is specifically defined. Sec. 528(c).

B. Taxable income is gross income (excluding exempt function income) less deductions directly connected with the production of the gross income (excluding exempt function income). Sec. 528(d)(1).

1. There is a specific deduction of $100.

2. There is no net operating loss deduction.

3. Exempt function income is amounts received as dues, fees, or assessments from the homeowners. Sec. 528(d)(3).

VIII. There are some items, including some recent developments, which have particular importance to educational institutions.

A. All income derived from research and all deductions directly connected with such income are excluded from unrelated business taxable income. Sec. 512(b)(8).

B. Income derived from the lending of securities is not unrelated business income and is not income from debt-financed property. Rev. Rul. 78-88, I.R.B. 1978-10, 12.

C. Income derived from the lapse or termination of options, written in connection with the organization's investment activities, to buy or sell securities. Sec. 512(b)(5).

D. There is currently pending in the National Office of the Internal Revenue Service a technical advice request regarding television revenues received by colleges from athletic activities.

E. The sale of advertising space in programs for sports events or music or drama performances does not create unrelated business income. Reg. 1.513-1(c)(2)(ii).

F. The sponsoring of professional theater companies and symphony orchestras who give performances to which the general public is admitted does not generate unrelated business income. Reg. 1.513-1(d)(4)(iv) Example (2).

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G. Sale of advertising space in a student newspaper does not create unrelated business income. Reg. 1.513-1(d)(4)(iv) Example (5).

H. Operating and providing the organizational structure for a regional network of computers owned by exempt colleges and universities and used to collect and disseminate scientific and educational information to member schools is an exempt funotion. Rev. Rul. 74-614, 1974-2 C.B. 164.

I. The operation of a ski facility creates unrelated business income to the extent it is used by the general public. Rev. Rul. 78-98, I.R.B. 1978-11, 13.

J. Alumni tour programs for members and their families generate unrelated business income. Rev. Rul. 78-43, I.R.B. 1978-5, 11.

IX. There are some definitive rules applicable to hospitals.

A. Certain hospital services are specifically excluded from unrelated trade or business. Sec. 513(e).

B. All income derived from research and all deductions directly connected with such income are excluded. Sec. 512(b)(8).

C. Income from pharmaceutical sales to the general public which are not frequent or continuous is not unrelated business income. Rev. Rul. 68-374, 1968-2 C.B. 242.

D. A gift shop in the hospital will not generally be considered an unrelated trade or business. Rev. Rul. 69-267, 1969-1 C.B. 160.

E. A cafeteria or coffee shop which is not advertised and does not encourage use by the public will generally not generate unrelated business income. Rev. Rul. 69-268, 1969-1 C.B. 160.

F. A parking lot not for general public use is not an unrelated trade or business. Rev. Rul. 69-269, 1969-1 C.B. 160.

G. Real property leased to a medical group which provides services to patients will not be considered an unrelated trade or business. Rev. Rul. 69-463, 1969-2 C.B. 131.

X. Museums and arts organizations can have particular considerations.

A. The sale of greeting card reproductions of art works by an art museum is not an unrelated trade or business. Rev. Rul. 73-104, 1973-1 C.B. 263, but the sale of scientific books and city souvenirs by a museum of folk art constitutes an unrelated trade or business. Rev. Rul. 73-105, 1973-1 C.B. 264.

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B. The operation of a dining room, cafeteria, and snack bar by an art museum for use by the museum staff, employees and visitors does not constitute an unrelated trade or business. Rev. Rul. 74-399, 1974-2 C.B. 172.

C. The operation by a museum of its theater as a motion picture theater during hours the museum is closed generates unrelated business income. Reg. 1.513-1(d)(4)(iii).

XI. A travel program may or may not be considered an exempt function.

A. The conduct of travel study tours that include courses on the culture of the United States, foreign countries and nature studies taught by certified teachers is an exempt function. Rev. Rul. 70-534, 1970-2 C.B. 113.

B. The conduct of winter time ocean cruises during which activities to further religious and educational purposes are provided in addition to extensive social and recreational activities is not an exempt function. Rev. Rul. 77-366, I.R.B. 1977-41, 11.

C. The operation of a travel tour program for alumni association members and their families is an unrelated trade or business. Rev. Rul. 78-43, I.R.B. 1978-5, 11.

XII. There is little public information about assessments of tax for unrelated business income of churches.

A. For trade or businesses of churches carried on prior to May 27, 1969 gross income is excluded from unrelated business income for taxable years beginning before January 1, 1976. Sec. 512(b)(14).

B. A congressional committee reported in 1969 that some churches were engaged in operating publishing houses, hotels, factories, radio and television stations, parking lots, newspapers, bakeries, and restaurants.

C. No examination to determine unrelated business income can be made of a church unless the Internal Revenue Service believes that the organization is engaged in an unrelated trade or business and so notifies the church in advance. Sec. 7605(c).

D. Weekly bingo games conducted by paid operators constitute unrelated business. Smith-Dodd Businessman's Assn. 65 T.C. 620 (1975).

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THE LEGAL ENVIRONMENT: HAVE YOU BEEN SUED LATELY?

Raymond L. Hanson

1. Introduction.

A. Creating the Environment.

The most striking thing about the legal environment is the proliferation of attorneys. In 1977, 5,900 attorneys were admitted to practice in California, in 1976, 5,200 and in 1975, 5,600. In 1977 over 11,000 people took the State Bar examinations. I am also told that in 1976 31 new law schools opened in the State of California. At the Hastings College of the Law where I serve on the Board of Directors we had 5,000 applicants for 500 places in the class to enter law school in September of 1978. As the total number of attorneys in California is 59,000, this means that a great portion of the legal practitioners in this State are in their first 5 or 6 years of practice. There is an old saying in the law business that there is nothing so dangerous as a young attorney just out of law school because he has the right to sue but not the judgment or maturity to know when and who to sue.

B. Effect of Government Policy and Class Action Suits.

It would seem to follow that the tremendous emphasis on litigation is a result to some extent of this ever-increasing number of attorneys in this State.

The Government, both Federal and State, has encouraged litigation with a great maze of regulations, prohibitions, requirements and the encouraging of so-called public interest law firms and such organizations as the California Rural Legal Aid.

Another factor increasing the emphasis on litigation has been the development of the so-called "class action suit" under which the attorneys for a plaintiff can sue on behalf of numerous other people of the same "class." In the event the suit is successful, the attorneys for the plaintiff are often able to collect their fees from the defendant organization for their work in representing the class. This is contrary to the rule in most law suits requiring each side to pay its own litigation fees. An interesting example of a class action suit is found in the case of Tillman v. Wheaton - Haven Recreation, 517 Fed.2 1141 - 1975 in which suit was filed against the Board of Trustees of a tax-exempt charitable corporation on behalf of all of the black people in a community in Maryland because they were prohibited from participating in the activities provided by the corporation or using its facilities

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such as the swimming pool. Another interesting case is the so-called Sibley Memorial case discussed herinafter in detail.

C. Charitable Immunity Disappeared in California.

Over a hundred years ago the doctrine of charitable immunity was promulgated by the courts. This doctrine said, in effect, that a charitable corporation or a trustee of a charitable organization was immune from suit by anyone benefiting from the services of the non-profit corporation.

In other words, a patient at a hospital that was a non-profit charitable hospital could not sue the hospital in the event he or she was damaged through the negligence of the nurses or other personnel because of the hospital's immunity. This doctrine was in effect in California for many years. The last case in which it was set up as a defense that I know of was the case of Malloy v. Fong, 37 C.2d 356 (1951) in which it was argued that a boy who lost his foot in an accident while attending a church party was not entitled to sue the church or the minister of the church because of charitable immunity. The California courts said that charitable immunity was no longer the law in this State.

2. There is a Substantial Risk of Personal Liability of Directors and Trustees of Non-Profit Corporations.

A. General Statement.

The general rule on personal liability of directors or trustees of non-profit corporations in California is that individual directors are ordinarily not liable in their capacity as members of the board.

(i) Section 9504 of the Corporation Code provides:

"Directors of a non-profit corporation are not personally liable for the debts, liabilities, or obligations of the corporation."

This statutory language, however, does not protect the board member from personal liability for breaching his fiduciary duty to the corporation. Each member of the governing board of a non-profit corporation owes a fiduciary duty to the corporation. This means that a member of the board must use his office for the benefit of the corporation; it is a position of trust.

Directors of non-profit corporations which have financing through the sale of bonds also face a

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risk of potential liability for violations of Rule 10b-5 of the Securities Exchange Act of 1934. The extent of the risk will be discussed below.

B. Standards of Fiduciary Duties Owed to a Tax-Exempt Corporation.

The precise standard of the fiduciary duties a director owes to a non-profit corporation has been subject to debate. A 1954 California Court of Appeal case held that although a director of a non-profit corporation is held to the highest degree of honor and integrity, he is not personally liable for mistakes of judgment. (George Pepperdine Foundation v. Pepperdine, 126 Cal.App.2d 154, 159; 271 P2d 600). The Pepperdine case presented some unique facts. Here a non-profit corporation sued its own founder and principal benefactor, claiming that he as a board member mismanaged the funds of the corporation. Because of the fact that but for George Pepperdine's generosity and industry there would have been no corporation at all, nor any funds to mismanage, the Court explicitly declared that it would be manifestly unfair to hold him liable for mere mistakes in judgment in the management of the corporation's funds. Because of the unique factual situation involved in the Pepperdine case, one would be ill-advised to rely heavily on that decision as to the general issue of potential liability for members of a governing board of a non-profit corporation. I think it is poor law.

A case which would appear to substantiate this opinion is Holt v. College of Osteopathic Physicians and Surgeons, 61 Cal.2d 750, decided by the California Supreme Court in 1964, ten years after the Court of Appeals decision in Pepperdine. Although the Court in Holt was not called upon to decide the issue of non-profit directors' personal liability, it did cite with favor several law review articles which in part suggest standards of responsibility which may be interpreted as stricter than those imposed by Pepperdine. The Court in Holt did expressly overrule the Pepperdine decision to the extent that it limited standing to sue to the Attorney General. After the Holt decision, it would appear that a suit against allegedly negligent directors may be maintained by one or more other members of the governing board, and probably by the non-profit corporation itself.

A Court of Appeals case decided after Holt, followed the Holt suggestion of a higher standard of care. (Lynch v. John M. Redfield Foundation (1970) 9 Cal. App.3d 293; 88 Cal. Reporter 86). Lynch held that directors of charitable organizations must comply with strict trust principles in the performance of their duties. In Lynch, the Attorney General sued

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the Foundation and its three directors, alleging mismanagement by the directors in permitting cash to accumulate in a non-interest bearing bank account for approximately five years, in failing to manage the assets of the Foundation in a businesslike way, and in failing to carry out the Foundation's purposes for said period.

The directors argued that the circumstances should excuse what they admit would normally be mismanagement for retaining income in a non-interest bearing account for five years. The circumstances were that the money was kept there because of disputes and lawsuits among the directors which resulted in notification from the bank that it would not honor drafts on the Foundation's account without a court order unless all directors concurred in the action. The directors also asserted as mitigating circumstances the facts that they served without compensation, that the corpus gained approximately 100% in value during the period of inaction, and that they acted in good faith.

The court rejected these arguments and found that the directors breached the prudent man investment rule (the trustee's standard of care). The directors were surcharged for simple interest of 7% per annum for negligently breaching their trust by failing to invest income within a reasonable time.

C. A Landmark Case - Sibley Memorial Hospital - The Corporate Name is Lucy Webb Hayes National Training School for Deaconesses and Missionaries.

The most important recent decision on the scope of the director's fiduciary duty states that the directors of non-profit corporations will be held to the more lenient corporate principles rather than to the stricter trust principles of fiduciary duty. (Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries, 381 Fed. Supp. 1003.) This opinion by Judge Gerhard Gesell contains the most extensive discussion to date on the scope of the fiduciary duty owed by directors of non-profit corporations.

Patients of Sibley Memorial Hospital in Wash., D.C. brought a class action alleging among other things that nine members of the hospital's board of trustees breached their fiduciary duties of care and loyalty in the management of the hospital's funds. Since 1960, Sibley Memorial Hospital, a non-profit charit-

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able institution, maintained a board of trustees consisting of from 25 to 35 members. The board met twice each year. Between meetings of the board, an executive committee represented the board and among its duties were the opening of checking and savings accounts, approving the hospital's budget, and to report regularly on the amount of cash available for investments. Finally, the board had an investment committee which was to manage the investment of hospital funds, working closely with the finance committee.

From the early 1950's to 1968, financial management of the hospital was handled almost exclusively by two trustee/officers: Dr. Orem, the Hospital Administrator, and Mr. Ernst, the Treasurer. These men dominated the board and executive committees, whose other members routinely accepted their recommendations or ratified their actions. Also, since from the early 1960's to 1971 the finance and investment committees never met or conducted business, budgetary and investment decisions were handled by Orem and Ernst. In 1971, the finance and investment committees were activated, but Ernst, being the chairman of the finance committee and a member of the investment committee, continued to maintain dominant control over the hospital's financial management until his death in 1972.

Judge Gesell opted for applying corporate rather than trust principles in determining the liability of the directors of charitable corporations because their functions are virtually indistinguishable from those of their "pure" corporate counterparts. He held that a director of a charitable corporation is in default of his fiduciary duty to manage the fiscal and investment affairs of the hospital if it has been shown by a preponderance of the evidence that:

(i) While assigned to a particular committee of the board having general financial or investment responsibility under the by-laws of the corporation, he has failed to use due diligence in supervising the actions of those officers, employees or outside experts to whom the responsibility for making day to day financial or investment decisions has been delegated; or

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(ii) He knowingly permitted the hospital to enter into a business transaction with himself or with any corporation, partnership or association in which he then had a substantial interest or held a position of trustee, director, general manager or principal officer without having previously informed the persons charged with approving that transaction of his interest of position and of any significant reasons, unknown to or not fully appreciated by such persons, why the transaction might not be in the best interest of the hospital; or

(iii) Except as required by the preceding paragraph, he actively participated in or voted in favor of a decision by the board or any committee or subcommittee thereof to transact business with himself or with any corporation, partnership or association in which he then had a substantial interest or held a position as trustee, director, general manager or principal officer; or

(iv) He otherwise failed to perform his duties honestly, in good faith, and with a reasonable amount of diligence and care.

Upon applying these standards to the facts, the Court found that all of the standards had been breached. The Court declined to award damages or to remove the trustees from office. Its reasoning was:

> "In attempting to balance the equities under the circumstances shown by the record, there are a number of factors which lead the Court to feel that intervention by injunction should be limited. (Citation). First, the defendant trustees in this case constitute but a small minority of the full Sibley Board. Yet in several respects, the responsibility for past failures adequately to supervise the handling of hospital funds rests equally on all board members. Second, it is clear that the practices criticized by plaintiffs have, to a considerable extent, been corrected and that the employees and trustees who were principally responsible for lax handling of funds have died or been dismissed. Third, there is no indication

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that any of the named trustees were involved in fraudulent practices or profited personally by lapses in proper fiscal supervision, and indeed, the overall operation of the hospital in terms of low costs, efficient services and quality patient care has been superior. Finally, this case is in a sense one of first impression, since it brings into judicial focus for the first time in this jurisdiction the nature and scope of trustee obligations in a non-profit, non-member charitable institution incorporated under D. C. Code Sections 29-1001 et seq." Stern, supra, page 21 and 22.

D. Is It Law In California?

As noted in Stern, other states such as Kansas and North Carolina apply profit-making corporation fiduciary duty standards to directors of non-profit corporations. There is indication that New Jersey courts also apply corporate fiduciary duty standards and have found directors of non-profit corporations to have breached these standards. (Valle v. New Jersey Auto Club, 310 A.2d 518, 125 N.J. Super. 302 (1973)).

Stern is at present the leading case on the standards for the fiduciary duties of directors of non-profit corporations. It seems likely that California Courts would follow Stern by holding directors to profit-making corporation fiduciary standards. Even though Lynch which is the latest California case used more stringent trust fiduciary standards, it is probable that California courts in future cases would follow Stern in holding directors of non-profit corporations to the less stringent corporate standards for fiduciary duties. Lynch adopted the trust standards with no explanation for why trust rather than corporate standards were used. It appears that the court merely expanded the ruling from Holt v. College of Osteopathic Physicians and Surgeons (supra) that a non-profit corporation was similar to a trust so that persons other than solely the Attorney General could sue negligent directors. Therefore, if the question whether trust or corporate fiduciary standards should apply to directors of non-profit corporations were fully briefed, it is probable that a California court would find the Stern reasoning persuasive and would opt for corporate standards. Thus, a review of California law on fiduciary duties of directors of profit-making corporations seems appropriate.

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(i) California Law on Fiduciary Duties of Directors of Profit Making Corporations.

(a) Duty of Loyalty.

Section 820 of the California Corporations Code rather clearly states the rules on self-dealing:

"Duty to act in good faith; effect of personal financial interest of common directorship. Directors and officers shall exercise their powers in good faith, and with a view to the interests of the corporation. No contract or other transaction between a corporation and one or more of its directors, or between a corporation and any corporation, firm or association in which one or more of its directors are directors or are financially interested, is either void or voidable because such director or directors are present at the meeting of the board of directors or a committee thereof which authorizes or approves the contract or transaction, or because his or their votes are counted for such purpose, if the circumstances specified in any of the following exist:

(aa) The fact of the common directorship or financial interest is disclosed or known to the board of directors or committee and noted in the minutes, and the board or committee authorizes, approves, or ratifies the contract or transaction in good faith by a vote sufficient for the purpose without counting the vote or votes of such director or directors.

(bb) The fact of the common directorship or financial interest is disclosed or known to the shareholders, and they approve or ratify the contract or transaction in good faith by a majority vote or written consent of shareholders entitled to vote.

(cc) The contract or transaction is just and reasonable as to the corporation at the time it is authorized or approved.

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Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or a committee thereof which authorized, approves, or ratifies a contract or transaction."

(b) Duty of Care.

The duty of care is somewhat more difficult to define. A director has a duty to supervise the general operation of the corporation. (Corporations Code, Section 800). More specifically, the California courts appear to apply a negligence standard in determining the duty of care. (Burt v. Irvine Company (1965) 237 Cal.App.2d 828; 47 Cal. Reporter 29). In Burt, plaintiff had charged several directors with violating their duty by selling corporate assets to third parties at too cheap a price. In discussing the applicable standard of care to which the directors would be held, the Court quoted 3 Fletcher Cyc. of Corporations, 1965, Section 1040, page 628: "The rule exempting officers of corporations from liability for mere mistakes and errors of judgment does not apply where the loss is .. the result of the failure to exercise proper care, skill and diligence. Directors are not merely bound to be honest; they must also be diligent and careful in performance of the duties they have undertaken. They cannot excuse imprudence on the ground of their ignorance or inexperience, or honesty of their intentions; and, if they commit an error of judgment through mere recklessness or want of ordinary prudence and skill, the corporation may hold them responsible for the consequences."

The Burt court found that plaintiffs stated a cause of action where they alleged that defendant directors brushed aside or ignored bids on the assets sold which were known to be higher than those accepted.

The business judgment rule has been thought to protect directors from the imposition of liability. However, the more recent cases state that the business rule protects only reasonable acts of a director. (McDonnell v. American Leduc Petroleum Limited (1974)

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491 F.2d 380, 384). "When Courts say that they will not interfere in matters of business judgment, it is presupposed that judgment -- reasonable diligence -- has in fact been exercised. A director cannot close his eyes to what is going on about him in the conduct of the business of the corporation and have it said that he is exercising business judgment. Courts have properly decided to give directors a wide latitude in the management of the affairs of the corporation provided always that judgment, and that means an honest, unbiased judgment, is reasonably exercised by them. (Burt v. Irvine Company, supra, page 852.)

E. Rule 10b-5.

Director liability under Rule 10b-5 of the Securities Exchange Act of 1934 is a possibility to consider for non-profit corporations which finance through bond offerings. Rule 10b-5 makes it unlawful for any person in connection with the purchase or sale of a security to employ a scheme to defraud, to make a material misstatement or omission, or to use a fraudulent course of business.

An implied civil cause of action is recognized in Rule 10b-5. (Knepper, Liability of Corporate Officers and Directors 131, 2d ed., 1973). Professor Bromberg indicates that securities of non-profit organizations which are exempt from the 1933 Securities Act registration requirements are subject to 10b-5 coverage. (1A Bromberg, Securities Law: Fraud §2.4(3), p. 39 (1973)).

Attempts have been made to hold directors liable for damages for violations of Rule 10b-5. The requisite state of mind for finding civil liability for damages in 10b-5 suits is the most difficult and unsettled element of a 10b-5 private action. (2A Bromberg, Securities Law: Fraud (§8.4, p. 501 (1973)). The Federal Circuit Courts of Appeal have no uniform standard for the requisite state of mind. Professors Jennings and Marsh, after discussing the difficulty of figuring out the state of the law nationwide, suggest that it is unlikely that any court would in fact impose liability for damages upon even a corporate officer in favor of stock purchasers for simple negligence pertaining to something like the issuance of a press release. (Jennings and Marsh, Securities Regulation 3d., p. 1072 (1972)).

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An illustrative of the law on Rule 10b-5, cases from the 2nd Circuit (includes New York) and the 9th Circuit (includes California) will be discussed. A recent 2d Circuit case held that an outside director (one not in control of or employed by the corporation and who did not participate in the transaction) is not liable for damages under Rule 10b-5 when he did not know of or participate in the making of misleading statements or omissions. The court held that "a director in his capacity as a director (a non-participant in the transaction) owes no duty to insure that all material, adverse information is conveyed to prospective purchasers of the stock of the corporation on whose board he sits." (Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973)). The court held that Rule 10b-5 requires more than negligence for liability for a director -- it requires proof of a willful or reckless disregard for the truth. Lanza, supra.

A recent 9th Circuit case declared that a flexible standard should be applied in determining 10b-5 liability. In establishing defendant's duty under 10b-5, factors to consider are the relationship of defendant to plaintiff, defendant's access to information as compared to plaintiff's access, the benefit that defendant derives from the relationship, defendant's awareness of whether the plaintiff was relying on their relationship in making his investment decisions, and the defendant's activity in initiating the securities transaction. (White v. Abrams, 495 F.2d 724 (9th Cir., 1974)).

Thus, under the 9th Circuit standard, it appears that an outside director would probably not be held liable for a 10b-5 violation unless the director knew of the violation or had sufficient information available so that he should have known of the violation. The flexible standard would seemingly be most lenient for an outside director of a non-profit corporation. Thus, 10b-5 liability for damages in California seems a remote possibility.

F. Other Rules on Financial Management.

In addition to the above, members of the board of a non-profit corporation participating in the Medicare Program should be aware of certain obligations the provider has with respect to financial management. Specifically, board members should be concerned with the "Prudent Buyer Rule".

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The Prudent Buyer Rule requires that providers act as prudent buyers in the purchase of goods and services, i.e. that the provider seek out and take advantage of discounts and other economies available for the purchase of goods and services. In all cases where the provider fails to take advantage of additional discounts or economies, there must be clear justification for such action. Unless this justification exists, where a provider pays an amount above the going price of goods and services, this excess amount will be excluded in computing allowable costs under the Medicare Program.

The "Related Organization Rule" sets forth obligations with respect to the cost of goods or services provided to a provider from a related entity having common ownership or control. Generally the rules relating to common ownership will not be applicable to a non-profit corporation. Those relating to common control may be, however. "Control" under the rule exists where an individual organization has the power, directly or indirectly, to influence or direct to a significant extent the actions or policies of the provider. The rules do not set forth any specific set of circumstances as to when common control exists, but do state that the issue of control is based upon the totality of facts and circumstances in each case. Under the "Related Organization Rule", generally the cost of goods and services purchased by a provider from a related organization will be limited to the cost of such goods and services to the related organization and then only if such costs do not exceed comparable prices of goods and services purchased elsewhere. When costs of goods and services purchased from a related organization are deemed excessive, the excessive cost of such goods will be disallowed as a reimbursable expense under the Medicare Program.

With regard to both the "Prudent Buyer Rule" and the "Related Organization Rule", violation of either rule could provide the basis for consumer legal action against the corporation's board of directors alleging a breach of board members' fiduciary duties respecting financial management.

It should be further noted that a non-profit corporation's tax exempt status is based upon a requirement that no part of the net income of the corporation inure to the benefit of any private individual. The purchase of goods, services or money by a non-

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profit corporation at a price beyond that which might reasonably be justified may be deemed a transaction through which, in effect, revenue inures to the benefit of a private individual. Such a transaction could jeopardize the tax exempt status of the corporation and again could provide the basis for consumer action alleging a violation of board members' fiduciary obligations concerning management of the corporation's finances.

3. Higher Fiduciary Care.

A. The concept that funds handled by charity, even though incorporated, are charitable funds in the hands of a trustee and not of a corporation's board of directors is reflected in the thinking of the California Attorney General's staff which carries over the provisions of certain sections of the civil code regarding the obligations of a trustee to apply to the trustees or directors of tax-exempt corporations. It is important to note that Mr. Warren Abbott of that office believes these sections prohibit a professional man or woman (CPA, attorney, physician, etc) from serving as a trustee of a tax-exempt corporation and also receiving compensation for himself or herself or for his or her firm. As the practice, at least so far as attorneys are concerned, is widespread and well established, this interpretation could give rise to surcharge proceedings in many areas of the State. The important sections are as follows:

(i) §2228. Bound to Highest Good Faith.

In all matters connected with his trust, a trustee is bound to act in the highest good faith toward his beneficiary, and may not obtain any advantage therein over the latter by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind.

(ii) §2229. Personal Interest and Profit Prohibited.

A trustee may not use or deal with the trust property for his own profit, or for any other purpose unconnected with the trust, in any manner.

(iii) §2230. Interest Adverse to Beneficiary - Exception.

Neither a trustee nor any of his agents may take part in any transaction concerning the trust in which he or any one for whom he acts

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as agent has an interest, present or contingent, adverse to that of his beneficiary, except as follows:

(aa) When the beneficiary, having capacity to contract, with a full knowledge of the motives of the trustee, and of all other facts concerning the transaction which might affect his own decision, and without the use of any influence on the part of the trustee, permits him to do so;

(bb) When the beneficiary not having capacity to contract, the proper court, upon the like information of the facts, grants the like permission; or,

(cc) When some of the beneficiaries having capacity to contract, and some not having it, the former grant permission for themselves, and the proper court for the latter, in the manner above prescribed.

(dd) Presumptions Against Transactions Between Trustee and Beneficiary.

All transactions between a trustee and his beneficiary during the existence of the trust, or while the influence acquired by the trustee remains, by which he obtains any advantage from his beneficiary, are presumed to be entered into by the latter without sufficient consideration, and under undue influence. The presumptions established by this section do not apply to the provisions of an agreement between a trustee and his beneficiary relating to the hiring or compensation of the trustee.

These Code Sections, when followed out, would necessarily put a tremendous burden on trustees of non-profit corporations going beyond that normally anticipated by the directors of profit making corporations as has been indicated above.

4. Indemnification and Insurance.

A. It is possible for a corporation in California to agree to indemnify its corporate directors or trustees. It is

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also possible for it to provide public liability insurance against negligence of directors and officers acting within the course and scope of their authority. It is probably not possible to obtain any type of insurance which protects a director or trustee against his own deliberate malfeasance.

B. Directors and officers liability insurance is difficult to obtain although many non-profit corporations have been able to obtain it. The insurance is normally limited to compensatory damages and costs of defense. In fact, many non-profit corporations have decided to purchase insurance only to protect against the costs of the defense and not to provide compensatory funds. A study of the losses in this area indicate that legal defense costs have averaged $114,000 per lawsuit, which is certainly reason for providing insurance against this type of cost. On the other hand, there have been very few awards against trustees individually. The most extensive loss I have heard of has been an award in a case still on appeal on the East Coast where the sum of $10,000 in damages was assessed against each trustee. Coverage of directors and officers of tax exempt corporations in the State of California has gone as high as $10,000,000 for this type of protection. It is my understanding that in some cases the insurance carrier requires that there be an Agreement of Indemnification of the trustees before they will normally cover the trustees. In this regard, it should be noted that the normal individual umbrella insurance policy carried by many persons does not cover liability incurred as a trustee of a charitable organization. Also, because of the self-dealing provisions a trustee of a private foundation will have to pay indirectly or directly that portion of the premium which does not relate to a successful defense or settlement of such a case. See Regulations 53.4941D-2F3. The applications for directors and officers liability insurance filed by non-profit corporations has increased tremendously, and, according to one insurance company, their applications increased five-fold during the last four months before the writing of this outline. This, of course, is indicative of the legal environment and the concern of trustees of non-profit corporations as to their personal liability.

5. Pending Legislation.

A. Assembly Bill 2065

The McAllister Bill is generally known as the charitable solicitation act and is now pending in the California Legislature. Insofar as it affects trustees' liability it has certain im-

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portant criteria under which the Attorney General's Office is authorized to determine whether trustees of a non-profit corporation should be surcharged for their conduct in the handling of charitable solicitation matters. This statute sets forth the criteria as follows:

(i) The reasonableness of costs of fund raising and administrative expenses, including amounts paid to registered fund raisers (taking into account the methods of fund raising used;)

(ii) The effort spent in investigating the likelihood of success, or lack thereof, of a particular solicitation campaign and the expected costs thereof;

(iii) Present costs in relation to long-term goals such as the expectation of gifts to be obtained in the future by the use of trusts, wills, and similar deferred types of gifts;

(iv) The necessity for newly created charitable organizations to incur significant costs in establishing themselves and their programs;

(v) Participation and dedication evidenced by trustees, directors, officers and others responsible for the solicitation of funds by a charitable organization and any compensation or other remuneration received by persons as a result of efforts expended by them in participating in such solicitations;

(vi) The establishing of procedures, or failure to do so, for purposes of accurately accounting for and protecting funds of a charitable organization.

Provided, however, that in considering the propriety of any such activity all relevant facts and circumstances shall be considered.

B. The Proposed Non-Profit Public Benefit and Non-Profit Mutual Benefit Law - Assembly Bill 2180 (Knox Bill).

(i) The Need for AB 2180.

It is essential that California have a new law governing non-profit corporations, for the present law is inadequate in scope and uncertain in application. The present law incorporates by reference a business corporation

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law repealed on January 1, 1977, and existing in limbo only for purposes of such incorporation by reference. This reference to the statutes governing business corporations results in significant problems. For example, the business law sets forth rules governing shareholders, dividends, and complex economic relations. How do such rules apply to problems governing nonprofit corporations? What standards govern the conduct of directors of non-profit corporations -- the business standard or trust rules? AB 2180 was drafted to set forth, in one Division of the Corporations Code, the principles of corporate law that apply to the formation, internal governance, and dissolution of non-profit corporations and to answer some of the unique questions such corporations present.

C. An Important Basic Division of Non-Profit Corporations.

The proposed law divides all of the corporations presently governed by the current general non-profit law into two groups which are labeled "non-profit public benefit corporations" and "non-profit mutual benefit corporations". Public benefit corporations are those formed for a public charitable or religious purpose; they are not operated for the mutual benefit of the members, but for some broader good. Members of the public benefit corporations have no ownership interest in them. Upon dissolution of the corporation the assets must go to a similar non-profit corporation or charitable organization rather than to the members. Public benefit corporations include all of the traditional "charitable" corporations. The proposed law avoids the term "charitable", however, in order to distinguish it from the tax laws which might give the word "charitable" a more restricted meaning.

The other category, the mutual benefit corporation, includes every other kind of corporation formed under the proposed law. The diversity of these organizations is enormous; however, they all share common characteristics; they cannot distribute gains, profits or dividends to members except upon dissolution and therefore are non-profit. In addition, they are formed principally for the mutual benefit of their memberships (fraternal organizations,

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tennis clubs)or for the mutual benefit of all those engaging in a particular type of business (trade association) or activity (automobile club). Non-profit mutual benefit organizations may operate for the benefit of members and non-members alike; in fact, one California corporation operates for the benefit of more than 500,000 small businesses which are not members of the organizations within the meaning of the proposed new law. Members in some mutual benefit corporations may have a proprietary interest which allows them to receive its assets upon dissolution, while in others the assets go to another non-profit corporation. In many mutual benefit corporations the proprietary interest, if any, is more theoretical than real.

It is important that CPAs be well-informed on the new law if it is adopted, because it has very specific definitions of authorized members, quorums, voting powers and other items which will enter into any audit that is undertaken after the passage of the new law, if in fact it is passed.

D. Solving the Standard of Care for Trustees.

As pointed out previously in this outline, there is a difference of opinion as to what constitutes the California law governing the duty of care owed by trustees of non-profit corporations. While many attorneys feel that the general corporate law standards as indicated in the Sibley Memorial Hospital case are applicable, there are, of course, those including the Attorney General's representatives, who feel that the trustee standards apply. The new statute intends to solve this difficulty and hence has adopted the following standard of care as part of the new statute. The statute provides as follows:

> "A director should perform the duties of a director....with care, including reasonable inquiry, as an ordinarily prudent person would use under similar circumstances."

In addition, the proposed law allows a director in meeting the duty of care to rely on officers, employees, committees of the board, and persons whom the director in good faith believes to be reliable and competent. This provision is consistent with the general corporate law and provides a needed protection to directors which is not found in the old non-profit law. In transactions

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between a director and a public benefit corporation, they must be approved by the Attorney General in advance or they must meet specific requirements set forth in Section 5333. Section 5333 should enable public corporations to take advantage of opportunities available to them while at the same time protecting them from potential abuses.

If directors of public benefit and mutual benefit corporations comply with the duty of care and the duty of loyalty set forth in the proposed code, they have no liability based upon any alleged failure to discharge their obligations as directors. Sections 5331(c) and 7731(c).

Section 5327 requires that 51% of the board of directors of public benefit corporations must be persons who do not receive compensation for services rendered to the corporation. This provision is designed to curb self-dealing transactions to insure the majority of the board is not economically interested in or dependent upon a corporation.

E. Crimes and Penalties

One chapter regarding each type of new corporation deals with crimes and penalties; a $50 per year civil penalty is specified for failure to file the annual report. The wide variation in size and formality of corporations covered by the non-profit law apparently discouraged the setting of more stringent penalties for failure to abide by other formal filing or paperwork requirements.

F. Transition Provisions.

In general, the new law applies to all acts, contracts or transactions after the operative date of the bill, January 1, 1980. Unnecessary re-writing of existing articles and by-laws is not required. Entities filing for incorporation close to the operative date of the new law are allowed to form under the prior non-profit law despite some delays in processing beyond January 1, 1980. The process of choosing a new status should be completed by January 1, 1980. The proposed law provides, however, that if a corporation objects to its designation and cannot resolve the matter with the Secretary of State, suit may be brought up to January 1, 1982 to finally resolve the matter.

G. Effect on Account Firms of Knox Bill.

It is contemplated that CPAs, as well as attorneys, will find it necessary to change all of their check-out procedures and auditing procedures in connection with the new act. It will also require careful study as this is intended to be a bible for future operation of non-profit corporations.

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CONCLUSION

In conclusion, under California law, a trustee may be sued for the following reasons despite the provisions of Section 9504 of the Corporations Code:

A. Conduct prejudicial to the corporation itself, even though done in good faith.

B. Conduct which damages third persons through negligence or deliberate misconduct.

C. Conduct which the California Attorney General considers improper in the handling of funds or the making of contracts and which leads to a possible surcharge by the Attorney General against the trustee or trustees, and,

D. Acts in violation of various state and federal statutes such as:

(i) violations of responsibilities under the Internal Revenue Act,

(ii) violation of responsibilities under the Pension Reform Act of 1976 (ERISA) which imposes on trustees certain fiduciary responsibilities;

(iii) violation of provisions set by the Securities and Exchange Commission for responsibilities and duties with respect to securities;

(iv) violation of civil rights, such as discrimination, failure to carry out affirmative action programs and related matters;

(v) violation of State and Federal charitable solicitation laws.

In addition, many of the current provisions of the non-profit corporation law will be changed if Assembly Bill 2180 (the Knox Bill) should pass and bring in to being two entirely new types of non-profit corporations known as (1) the public benefit corporation or (2) the mutual benefit corporation.

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