

# TAXATION SECTION



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**Statement of the Section of Taxation  
District of Columbia Bar  
on the  
District of Columbia Nonprofit Corporation  
Amendment Act of 1991 (Bill 9-316)  
Before the  
Committee on Consumer and Regulatory Affairs  
Council of the District of Columbia**

**April 9, 1992**

## Committees:

Business Related Taxes  
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Exempt Organizations  
Tax Audits and Litigation

I am Suzanne McDowell, Chair of the Exempt Organizations Committee of the Section of Taxation of the D.C. Bar.<sup>1</sup> I am pleased to have this opportunity to appear before you to present the views of the Tax Section on Bill 9-316, the District of

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<sup>1</sup> The views expressed herein represent only those of the Section of Taxation of the District of Columbia Bar and not those of the District of Columbia Bar or the Bar's Board of Governors. The Section of Taxation is comprised of approximately 1,400 members. Members of the Section's Tax Policy Task Force and Steering Committee participated in the preparation of this statement. The members of the Steering Committee and Tax Policy Task Force are: Stephen A. Nauheim (Co-Chair, Steering Committee), Celia Rody (Co-Chair, Steering Committee), Donald C. Lubick (Co-Chair, Tax Policy), O. Donaldson Chapoton (Co-Chair, Tax Policy), Stephen Csontos, Ellen A. Hennessy, Gerald A. Kafka, Patricia G. Lewis, Charles B. Temkin, Joseph A. Rieser, F. David Lake, Jr., J. Mark Iwry, Marian S. Block, Lynn K. Pearle, James E. McNair, Barbara L. Kirschten, Jane C. Bergner, Richard C. Stark, Collette C. Goodman, Leonard J. Henzke, George P. Lavendis, Reeves Westbrook, C. David Swenson, Steven Welles and Blake Rubin. Miriam Galston, Associate Professor, The National Law Center, George Washington University, also participated in the preparation of this statement.

Columbia Nonprofit Corporation Act of 1991. The D.C. Bar has an active Exempt Organizations Committee composed of lawyers who represent exempt organizations as a significant part of their law practices. Many of our members represent these organizations, not only with respect to tax matters, but also with respect to a wide variety of other legal issues. As such, we are in a unique position to comment upon the bill.

### Background

The proposed legislation deals with a difficult issue. On the one hand, directors, officers and other persons serving nonprofit corporations should be held accountable for their actions, and those who suffer losses or injuries as a result of wrongdoing by such persons should be compensated. On the other hand, it is in the public interest that we encourage able and talented citizens to volunteer their services to nonprofit corporations. Fear of personal legal liability currently leads many individuals who would like to volunteer their services to decline to do so.

Although it is difficult to document whether the number of lawsuits and judgments against nonprofit corporation volunteers has increased, there is clearly a perception that this is the case. This perception has been fueled by the skyrocketing costs of liability insurance in the mid-1980s and the publicity that many cases against nonprofit corporations have received. Whatever the actual number of cases may be, it is clear that many individuals are concerned that they will be risking loss of their personal

assets if they volunteer their services to nonprofit corporations. As a consequence, many nonprofit organizations have found it has become more difficult to recruit individuals to volunteer to serve as directors, officers, and in other capacities. A Gallup Poll survey conducted in 1987 indicated that nearly 20 percent of all nonprofits had had volunteers resign or withhold services because of concerns about potential liability.

There is no satisfactory solution to this problem other than legislation. Although insurance can be acquired to protect directors and officers from liability ("D & O liability insurance"), it has a number of shortcomings. First, premiums for such insurance are very high, particularly compared to insurance for corporations. Although we have not been able to find any reliable statistics, anecdotal evidence suggests that premiums for D & O liability insurance begin at about \$1,000 for a very small nonprofit and can be substantially more. Premiums for corporate liability insurance begin at about \$500, or about one-half the amount of D & O insurance. Second, the typical D & O liability policy for nonprofit corporations excludes many claims from coverage, such as libel and slander, bodily injury, pollution and environmental damage claims, ERISA violations, and discrimination claims. Coverage for much of the excluded liability can be acquired, but small nonprofit corporations often lack the knowledge and expertise to negotiate such coverage. Third, coverage is not typically available for volunteers other than officers and directors. Fourth, liability coverage does not compensate the

affected individuals for the time they spend defending themselves against a suit, which can be substantial, or for the anxiety associated with being named a defendant in a lawsuit. For these reasons, legislation is necessary.

Virtually every state has recognized the need for legislation and has enacted a law dealing with volunteer immunity in some fashion. Most of the statutes, like the District's proposed legislation, do not provide protection in the case of willful and intentional misconduct, and many exclude actions resulting from bad faith or gross negligence. Some states also exclude specific actions such as claims arising out of motor vehicle accidents, malpractice claims against healthcare providers, and certain actions brought by the attorney general. A few states, including Maryland, require that the organization carry specified insurance. Some states impose a cap on the amount a plaintiff may recover.

#### Discussion

The proposed legislation strikes a reasonable and fair balance between the competing interests at stake. If a nonprofit corporation carries specified insurance, its directors, officers, and other volunteers would be immune from personal liability unless the injury or damage was the result of: (1) the volunteer's willful misconduct; (2) a crime (unless the volunteer had reasonable cause to believe the activity was lawful); (3) a transaction resulting in an improper benefit of money, property or services to the volunteer; or, (4) an act or omission that was not in good faith

and was beyond the scope of the authority of the corporation. The effect of this provision would be to protect volunteers from personal liability in cases of simple negligence, but to hold them accountable for other actions as enumerated above. The protection accorded volunteers in the case of simple negligence should be sufficient to quell the fears of liability that currently deter some individuals from volunteering their services. At the same time, the exceptions enumerated in the bill retain a degree of accountability that should be sufficient to encourage volunteers to act with care.

The bill would assure that volunteers do not receive protection at the expense of those who are harmed by their acts or omissions, by providing that its immunity provisions apply only if the corporation maintains insurance "liability coverage of at least one million dollars and bodily injury coverage of at least one million dollars per occurrence." This provision of the bill also will probably have the desirable effect of increasing the number of nonprofit organizations that carry liability insurance.

This bill also would serve the interests of the District of Columbia and its citizens. Generally, lawsuits are governed by the law of the jurisdiction where a corporation is incorporated, the law of the jurisdiction of its principal office, or the law of the jurisdiction where the wrongful act occurred. If the District does not enact a law comparable to those of other jurisdictions, it can expect that many organizations will choose to incorporate in, and locate their principal offices in, states that have volunteer

immunity statutes, particularly Maryland and Virginia, rather than in the District. This would hurt the District's citizens because they would lose the benefit of the services that many of these organizations provide, and it would hurt the District's economy because it would lose the opportunity to provide these organizations with rental property, merchandise and services. Enactment of this legislation would bring the District's law into line with other jurisdictions.

Although we support the bill, we believe some minor changes would make it even better. First, the requirement that an organization carry one million dollars of liability insurance and one million dollars of bodily injury insurance may be too burdensome for some small organizations, and may provide plaintiffs with a windfall if the insurance is well in excess of the organization's gross receipts or assets. Indeed, insurance coverage that is excessive could even encourage frivolous lawsuits. We suggest that the bill require less insurance coverage for small organizations. For example, a provision could be modelled on the California law which required \$500,000 insurance for organizations with an annual budget of less than \$50,000.<sup>2</sup> The Council may also want to consider reducing the amount of insurance coverage required for larger nonprofit organizations. We are not aware of any other jurisdiction that has an insurance requirement as high as two

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<sup>2</sup> The California law was effective until January 1, 1992. This "sunset provision" was included in the statute in order to provide an opportunity to re-evaluate the law. New bills to provide immunity for volunteers are currently pending in the California Assembly.

million dollars. California required \$1,000,000 of liability insurance for organizations with annual budgets of \$50,000 or more. Maryland requires \$500,000 of insurance coverage as a condition of immunity. It is important to keep in mind that the statutory requirement only establishes a minimum. Many organizations, as a matter of sound business practice, will carry larger amounts of insurance.

Second, the definition of volunteer should be clarified. The bill should provide that a nonprofit organization's provision of insurance to protect its volunteers from personal liability would not be treated as compensation, and thus would not affect the volunteer status of insured individuals under the bill. Even if this bill becomes law, many organizations may wish to purchase insurance to protect volunteers from liability that would not be covered by the proposed legislation. For example, under the Supremacy Clause of the United States Constitution, federal claims against volunteers would not be affected by the bill. Further, organizations may wish to insure their volunteers against claims arising under the laws of jurisdictions other than the District of Columbia. In addition, nominal benefits received by volunteers should not be considered compensation for purposes of defining a volunteer.

Third, section 113(a)(5) of the bill provides that a volunteer shall not be immune from liability if the wrongful act or omission "is not in good faith and is beyond the scope of the authority of the corporation" (emphasis added). We suggest that the word "and"

in the quoted phrase be changed to the word "or". As currently drafted a volunteer would be immune from liability unless the act or omission in question was both in bad faith and beyond the scope of authority of the corporation. We believe that either of these criteria should result in the volunteer being liable for his or her act or omission.

In summary, while we think the bill could be improved in some minor respects, the Section of Taxation strongly supports enactment of Bill 9-316. The proposed legislation would meet a pressing need of nonprofit organizations in a manner that takes into account the important competing interests at stake.