



# FRATERNAL LAW™

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## DORMANT CHAPTER HOUSES

When a collegiate chapter of a national fraternity or sorority loses its charter or otherwise becomes dormant, whether permanently or temporarily, special attention must be paid to the operation and management of the chapter house. Without careful planning, significant negative tax and related consequences could result.

### Background

National housing corporations and local chapter houses typically are organized as non-profit corporations that qualify as social clubs exempt from taxation under § 501(c)(7). Maintaining an exemption under § 501(c)(7) subjects an organization to a number of rules and restrictions, including restrictions on sources of gross receipts.

The tax-exempt purpose of a 501(c)(7) organization is to provide pleasure and recreation to its members. The Internal Revenue Service labels a social club's activities that are in pursuit of its exempt purposes as "traditional activities," while those activities that are not in pursuit of exempt purposes are "nontraditional activities." Engaging in nontraditional activities jeopardize a 501(c)(7) organization's tax exemption. Limited IRS guidance indicates that if the percentage of gross receipts from nontraditional activities is less than 5%, the nontraditional activities would be insubstantial and would not affect an organization's tax exempt status. This guidance is informal and subject to change. A 501(c)(7) organization conducts nontraditional activities at its own peril.

Limitations on gross receipts from traditional activities depend, in part, on whether the gross receipts are from members or nonmembers. A 501(c)(7) organization generally is supported by its members through membership fees, dues and assessments and other revenue from the use of club facilities by members. Up to 35% of a 501(c)(7) organization's gross receipts, including investment income, can be from sources outside of the organization's membership. Within that 35%, not more than 15% of a social club's gross receipts can be derived from the use of a club's facilities or services by the general public. If a social club fails the gross receipts test, then all of the facts and circumstances will be considered in determining whether the club should qualify for tax exempt status.

### The Problem

When a local chapter is dormant, no member income is available to support the financial obligations of the

501(c)(7) that holds the chapter house. In many cases, the natural reaction is to replace that income stream as quickly as possible, especially if the property is mortgaged. But if maintaining tax-exempt status is important – and it usually is if there is any hope for reinstatement of the local chapter – you must carefully evaluate under what circumstances member income may be replaced with income from nonmembers.

The problem is the same whether the local chapter house is owned by a national housing corporation that owns multiple properties or a separate organization that owns only the local chapter house, although the solutions may differ.

### Possible Solutions

#### *National Housing Corporation*

- 1) If the organization is not dependent on the income stream, it may be able to leave the property dormant and simply wait for reinstatement of the local chapter.
- 2) If the local chapter house is owned by a national housing corporation that owns multiple properties, renting one house to non-members may not cause the national housing corporation to lose its tax-exempt status. If there is sufficient member income from other sources, new gross receipts from non-members may be below the permitted thresholds under the nontraditional income and gross receipts tests. The non-member income likely would be taxable to the national housing corporation.
- 3) If the national housing corporation does not have enough cushion in the gross receipts test to absorb additional non-member income, the corporation could consider placing the property in a subsidiary that qualifies for tax-exempt status as a title holding corporation under § 501(c)(2). This approach typically would be an option only if the property were mortgaged or there are related operating expenses. A 501(c)(2) entity must exist for the sole purpose of owning property, collecting income from the property and turning over that income (less expenses) to another tax exempt entity. A 501(c)(2) entity may only break even and have no additional funds to pay to its parent corporation (in this instance, the national housing corpo-

ration). Under this scenario, the local chapter house could satisfy its own carrying costs without adversely affecting the national housing corporation's tax-exempt status. The parent corporation and the 501(c)(2) subsidiary must file separate tax returns. If the two entities were to file one consolidated return, then the subsidiary's gross receipts (without subtracting expenses) would also be gross receipts of the national housing corporation.

#### *Locally-owned Chapter House*

- 1) Under the right circumstances, a locally-owned chapter house may choose to do nothing and remain dormant. This typically would be an option only if there were no mortgage or other significant expenses and the local chapter expected to be reinstated within a reasonable amount of time. Dormancy could solve the nontraditional income and gross receipts issue, but it could lead to another problem. The IRS has revoked the tax exempt status of dormant organizations that had no prospects for returning to active status.
- 2) A dormant locally-owned chapter house may not accept *any* non-member income because it has no member income to offset income from non-members. One solution is to temporarily redefine the membership of the chapter house. For example, a 501(c)(7) originally organized for the benefit of Fraternity X could amend its charter or articles of incorporation to include members of Fraternity Y. This approach must be employed with careful attention to detail. It is essential that Fraternity X retain control of the board of directors of the 501(c)(7) such that the board may amend the charter or articles of incorporation to redefine the membership class in its sole discretion. This solution ensures that rent received is income from members, thus averting any issues with the nontraditional income and gross receipts tests.

- 3) Creating a § 501(c)(2) subsidiary might also be an option for a locally-owned chapter house. As described above, if the property is rented on a break-even basis, the subsidiary would have no income to turn over to the 501(c)(7) parent and, accordingly, the parent organization would not risk violating the gross receipts test. This is not a viable long term solution, however, if the local chapter has no prospects for becoming active again.
- 4) A final option is to intentionally fail the § 501(c)(7) rules and operate on a for-profit basis. If there is any hope of reinstatement of the dormant chapter, however, this should be avoided using one of the solutions described above. If the chapter were reinstated, the local chapter house would be required to seek reinstatement of its tax-exempt status with the IRS. In addition, if a significant period of time passes between the transition from non-profit to for-profit and back to non-profit occurs, the transfer of the property back to non-profit ownership could be taxable.

#### Questions?

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#### **About Robinson, Bradshaw & Hinson, P.A.**

Robinson, Bradshaw & Hinson, P.A. is distinctive in its commitment to providing specialized legal services to nonprofit organizations. As a full-service, business-oriented law firm, we are uniquely positioned to provide sophisticated and cost-effective counseling and representation to our nonprofit organization clients including national fraternities, sororities and their affiliate foundations and housing corporations. We have extensive experience representing a diverse group of nonprofits in all aspects of their organization, administration and management.

## **STUDENT KILLED IN ACCIDENTAL SHOOTING AT FLORIDA STATE FRATERNITY**

Police were called to the Lambda Chi Alpha chapter house at Florida State University at 1:16 a.m. on Sunday, January 9, 2011. Ashley Cowie, a 20 year-old sophomore at FSU and a member of Chi Omega, was visiting friends at the fraternity chapter house. Evan Wilhelm, a member of the fraternity, was apparently showing off his rifle to several friends. As of now, it is unclear exactly what hap-

pened, but the gun accidentally discharged and Ms. Cowie was shot in her chest and died as a result of her injuries. Mr. Wilhelm has been charged with manslaughter.

That same weekend, Jared Loughner opened fire at a public event Congresswoman Gabrielle Giffords was holding in Tucson, Arizona. Representative Giffords survived the shooting despite being shot in the head. However, 6 innocent

people, including a federal judge and a 9 year-old girl were killed. Mr. Loughner is in custody and has been charged with murder.

On April 16, 2007, Seung-Hui Cho killed 32 people and wounded many more on the campus of Virginia Tech University in two separate shooting incidents. Cho committed suicide before he could be arrested. The Virginia Tech shooting is the deadliest shooting incident in American history by a single gunman.

Gun control has always been a hot button political issue. Following each tragic event, the national debate is revived. After the Virginia Tech shooting, the issue of guns on campus has received considerable attention around the country. For example, in Colorado, Students for Concealed Carry on Campus, a national organization that pushes legislation to allow students to carry concealed weapons on college campuses, filed a lawsuit challenging the University of Colorado's ban on weapons on campus. The Colorado Court of Appeals reversed an earlier ruling by the trial court that dismissed the lawsuit.<sup>1</sup> The case is currently before the Colorado Supreme Court. The Brady Center to Prevent Gun Violence has filed a brief urging the Supreme Court to dismiss the lawsuit.

The Brady Center, upon filing its brief, stated, "We urge the Court to allow the University of Colorado to protect students and faculty from the severe risks posed by guns. Parents should be able to send their children to college knowing that other students and visitors cannot be legally armed with semi-automatic weapons in dorm rooms, fraternity houses, and classrooms."

On January 13, 2011, the Virginia Supreme Court handed down its decision in *Digiancinto v. The Rector and Visitors of George Mason University*.<sup>2</sup> In that case, the Virginia Supreme Court held that George Mason's gun policy was constitutional. George Mason's gun policy states:

"Possession or carrying of any weapon by any person, except a police officer, is prohibited on university property in academic buildings, administrative office buildings, student residence buildings, dining facilities, or while attending sporting, entertainment or educational events. Entry upon the aforementioned university property in violation of this prohibition is expressly forbidden."

The Court upheld the regulation under both the Virginia Constitution and the 2<sup>nd</sup> Amendment of the United States Constitution, finding that due to the sensitive nature of campus, the regulation was properly tailored and was a reasonable regulation.

The issue of whether public schools can ban firearms on campus is sure to come up over and over again until and unless the United States Supreme Court more definitively weighs in on the issue. While the issue of firearms on campus may be subject to legitimate constitutional debate, the issue of firearms in Greek houses is not. The 2<sup>nd</sup> Amendment does not apply to Greek organizations (remember, the Constitution protects against governmental action only). A national fraternity or sorority, or its chapters, can legally impose a rule against firearms on fraternity property and similarly a house corporation could provide for such a prohibition in its lease with the chapter. There is certainly no guarantee such a rule would prevent tragedies like the death of Ashley Cowie, but questions of liability will no doubt arise when weapons allowed in a chapter house are not controlled.

• Daniel J. McCarthy

<sup>1</sup> Students for Concealed Carry v. The Regents of the University of Colorado, Court of Appeals No. 09 CA 1230.

<sup>2</sup> Digiancinto v. The Rector and Visitors of George Mason University, Case No. 091934.

## ARKANSAS DEMANDS INDEMNIFICATION

As reported in the November issue of Fraternal Law, a lawsuit was filed against Phi Delta Theta, some of its members and several administrators of the University of Arkansas. That suit grew out of conduct that led to one new member of Phi Delta Theta, who was underage, consuming so much alcohol that when he was taken to the hospital, his blood alcohol content was 0.68. That is 8.5 times the legal limit for driving in Arkansas.

Since the filing of that suit, a separate action has been filed directly against the University of Arkansas in the Arkansas State Claims Commission. The University, since it is a State institution, must be sued there. The Complaint against the University claims that the University "was negligent by not following policies, procedures and regulations and continued violations of those policies, procedures and regulations without repercussions to those groups, organizations or persons

violating them. Due to the continued negligence of the University of Arkansas, Nicholas Brown and subsequently his family received serious injuries."

In response, the university has demanded that the fraternity indemnify the university against this suit and provide protection to the university if it is found responsible for any damages.

The trend of universities demanding indemnification agreements from fraternities and sororities as a condition of recognition is one that should be watched carefully. It may have a significant long term impact.

• Timothy M. Burke

## SOCIAL MEDIA ALERT – FACEBOOK USED AGAINST RUSH CANDIDATES

In the ever growing age of social media, the challenges faced by fraternal organizations are not always as apparent as one might think. Recently, MSNBC reported (<http://on.msnbc.com/fiqs2y>) that numerous sororities in the south have been hit by a rash of what can most accurately be called cyber stalking. In these incidents, an individual passing as a sorority member by using a fake Facebook account complete with photos and names of current sorority members, contacts pledges and begins to inquire about the pledges' background under the guise of rush related activities. These questions begin innocently enough, and continue via Facebook over a period of days or weeks until the imposter begins to request more personal information and photographs. Ultimately these requests turn to an explicit nature, in which the pledge is asked to pose in various states of undress. If a pledge protests, the imposter continues to push, suggesting that failure to comply with the requests will result in the pledge's disqualification from the rush process. Scared of losing out on the chance to be part of the sorority, numerous pledges have relented to the requests and have been taken advantage of by this reprehensible activity. Once initial embarrassing information or photographs are provided, the imposter begins to blackmail the subjects seeking even more explicit material with threats of publishing the information to the pledge's friends and family.

While all can agree that this type of activity is abhorrent and one that no fraternal organization would ever knowingly allow to occur, there are ways that you can help ensure that your chapters are not victims. By instituting an official social media policy you provide your chapters with an important tool in fighting these attacks and also gain an opportunity

to avoid legal exposure in a wide range of areas. A comprehensive social media policy can dictate who may speak on behalf of your organization and provide pledges with a reference point if conduct ever becomes a concern. You may also wish to set forth whether rush related activities may occur via social media at all, and if so, provides a description of those activities, and designate certain identified individuals who are authorized to conduct rush activities. By providing this policy to pledges and current members, you give each of your chapters an important tool to protect their members. Additional guidance as to the nature of content and the ramifications of sharing private content on public social media pages can also be very valuable.

Providing training at the beginning of each semester provides an additional level of protection that serves to reinforce your policy and protect your members. Not only can policies and training help members avoid attacks such as those referenced above, they also can provide an important front line in limiting your organizations overall exposure to litigation. If your organization does not currently have a Social Media policy, now is the time to consider implementing one. Counsel experienced in the area can provide you with ideas on how to protect your chapters and provide valuable information to your members.

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## UPDATE ON CLS V. MARTINEZ

The Christian Legal Society case which earlier resulted in a 5 to 4 decision by the United States Supreme Court<sup>1</sup>, upholding the denial of recognition to CLS by Hastings College of Law was returned to the United States 9<sup>th</sup> Circuit Court of Appeals on the question of whether or not Hastings' policy requiring organizations to admit "all-comers," had been selectively enforced but added the limitation that the issue need only be considered by the lower court "if, and to the extent, it is preserved." The Ninth Circuit, having considered that question, ruled in mid November that the question had not been preserved.

CLS had presented a single issue when it initially appealed their case to the Court of Appeals. That was whether or not a public law school could, consistent with the Constitution, deny a religious student group the benefit of recognition because membership and officer status was limited based on religious belief. The 9<sup>th</sup> Circuit found that single issue did not

encompass the question of selective enforcement of the "all-comers" policy and therefore determined that it had no obligation to give any further consideration to the case.

While CLS could attempt to appeal again to the United States Supreme Court, it is unlikely that the court would consider this dispute again. Under these circumstances, it appears that the CLS case is at an end and the potentially troubling decision of the U.S. Supreme Court will stand as is.

- Timothy M. Burke

<sup>1</sup> *Christian Legal Soc'y of the Univ. of Cal. v. Martinez* 130 S. Ct. 2971 (2010)

<sup>2</sup> *Christian Legal Soc'y of the Univ. of Cal. v. Woo*, Ninth Circuit Court of Appeals, (9<sup>th</sup> Cir. Nov. 17, 2010) 2010 U.S. App. LEXIS 23727

## INJURED FORMER PLEDGE SUES PHI GAMMA DELTA

“In or about September of 2010, the members of the Pi Deuteron chapter began making preparations for their FIJI Island party. As part of these preparations, the active members ordered the pledges to construct a pool in the back yard of the fraternity house using sandbags. The pledges spent hours doing so, despite the fact that this was an activity that defendants had specifically told the parents was wrong and would be stopped....”

The FIJI Island party took place on or about September 17, 2010. During the course of this party minors were allowed to consume alcohol, and various pledge members were ordered to enter the pool that had been built on the property. During the course of the evening plaintiff was ordered by an active member to dive into the pool. He did so and as a result sustained sever injuries, including permanent spine damage and paralysis.”

These paragraphs appear in a lawsuit filed on December 29, 2010 in the Circuit Court of Jackson County, Missouri. The lawsuit, filed by Matt Frizie, seeks damages for injuries, including paralysis, the plaintiff allegedly sustained after he was ordered to dive into a makeshift pool at the Phi Gamma Delta’s Pi Deuteron Chapter at the University of Kansas in Lawrence.

The named defendants in the case are the Phi Gamma Delta Chapter House Association (the local house association), The Fraternity of Phi Gamma Delta (the national organization) and David R. Smith (a member of the house association). Mr. Smith was named as a defendant, according to the complaint, because in the summer of 2010, he wrote a letter to the parents of new pledges of the chapter and acknowledged that the chapter “was engaging in ‘practices that were barely acceptable in the 1980s.’” Mr. Smith allegedly promised the parents that he and the house association would do “everything in [their] power” to supervise the chapter and would “enact sweeping changes” to protect the chapter’s pledges. After he sent the letter, Mr. Smith allegedly continued to communicate with the pledge’s parents and promised to supervise the chapter and protect the pledges.

The complaint further details the events leading up to party at which plaintiff was injured. Despite specific rules from the national fraternity prohibiting pools or ponds at FIJI Island parties, the Pi Deuteron chapter ordered their pledges to construct a pool using sandbags and a tarp. The construction of the pool allegedly took three weeks, during which time Mr. Smith, other members of the house association and at least one member of the national fraternity staff visited the chapter but did not put a stop to the construction of the pool.

The plaintiff alleges that the defendants were negligent for failing to discover the pool, failing to supervise and control the chapter, failing to supervise the FIJI Island party, failing to take reasonable actions to protect plaintiff, failing to keep fraternity premises in a safe condition, failing to use rea-

sonable care to enforce rules governing the construction of pools, hazing and alcohol consumption, and failing to protect plaintiff against harm caused by violations of fraternity rules or harmful acts that were likely to occur.

The defendants have not yet filed their answers to the complaint. This case is yet another unfortunate reminder that all Greek organizations must continue to be diligent in enforcing their alcohol and social policies. We will keep you updated as this case progresses.

• Daniel J. McCarthy

### SEARCH HELD UNREASONABLE

The Supreme Judicial Court of Massachusetts recently upheld the rights of students in their dormitory room to be free from unauthorized searches by law enforcement personnel.<sup>1</sup>

Responding to the report of weapons being seen in a dormitory room, uniformed Boston College law enforcement personnel came to the room, questioned the students who lived there and ultimately asked for permission to search the room. The students did not fill out or sign the consent to search form and both the trial judge, and ultimately the Supreme Court, found that the students had not consented to the search.

The Supreme Court made it clear that when there is an attempt to rely on the consent to a warrantless search, “under both the Fourth Amendment [to the United States Constitution] and Article 14 [of the Massachusetts Declaration of Rights], the prosecution has the burden of proving that the consent was, in fact, freely and voluntarily given. In this case, the court could not find such free involuntary agreement and, therefore, upheld the trial court’s suppression of the evidence of drugs and drug paraphernalia that was discovered during the search of the students’ room.

The decision is not particularly surprising given the language of the Fourth Amendment, which assures “the right of the people to be secure in their persons, houses, papers and affects, against unreasonable searches and seizures, shall not be violated....” Just as it applied in the Boston College dorm rooms, it equally applies in fraternity houses and the rooms of fraternity members living in those houses.<sup>1</sup>

• Timothy M. Burke

<sup>1</sup> *Commonwealth v. Carr*, 458 Mass. 295 (2010).

## PURDUE WITHDRAWS RECOGNITION OF FRATERNITY

Recent news reports indicate Purdue University is stepping up actions against those fraternity chapters who encourage or require underage drinking by their members.

In November, the Phi Kappa Theta Chapter, which was already on probation, was told that they would lose their university recognition as a result of an event where pledges were encouraged to take part in a drinking game. A 48 ounce bottle of malt liquor was required to be consumed while duct-taped to the hand of a new member. While new members were given the opportunity to opt out, only three

did. It is clear that giving members or pledges the opportunity to opt out of hazing or illegal drinking is not a defense.

The fraternity has appealed the loss of recognition.

In December, Delta Upsilon was suspended after a social event where hard liquor purchased with Chapter funds was provided to minors. A university spokesperson positively commented on the way the national fraternity had "stepped up" to deal with the Chapter following the imposition of the sanction.

- Timothy M. Burke

## JUDGE DISMISSES BERKELEY ZONING CASE

Judge Steven A. Brick, of the Superior Court of Alameda County, California, recently granted the defendants Demurrer to Complaint in *South of Campus Neighborhood Ass'n v. Interfraternity Council et al.*, Case No. RG10494360. As reported in the November 2009 and January 2010 issues of *Fraternal Law*, a neighbor of several fraternity houses and a neighborhood group sued 36 fraternity chapters on the UC-Berkeley campus, numerous house corporations and several individuals. The plaintiffs sought class action status and asserted 17 different allegations, ranging from disturbing the peace, public drunkenness, underage drinking and public drinking.

Through earlier motions and decisions, the case had been narrowed from what the plaintiffs originally filed. With Judge Brick's recent decision, there are no remaining claims. It is anticipated that the plaintiffs will appeal the decision.

In his decision, Judge Brick first addressed California's Social Host Immunity Statute. Unlike most other states, the law in California has long been that, "No social host who furnishes alcoholic beverages to any person may be held legally accountable for damages suffered by that person, or from injury to the person or property of, or death of, any third person, resulting from the consumption of those beverages." California Civil Code §1714(c).

Judge Brick, after noting that California recently changed its social host statute (see the November 2010 issue of *Fraternal Law* for more information), held that Section 1741(c), as it then existed (the new law had not yet become effective) barred the plaintiffs' negligence, nuisance and unfair competition claims against the defendants. The judge stated that, "the Court concludes that the essence of all of Plaintiff's claims is that Defendants allowed for the provision of alcohol and failed to adequately monitor the resulting behavior.... Accordingly, Civil Code §1714(c) applies and the Defendants are immune from liability."

The judge next addressed plaintiff's attempt to make the case a class action. In order to qualify as a class for a class action, the plaintiff must show: 1) numerosity

(adequate number of plaintiffs); 2) commonality (common damages and legal issues); 3) typicality (each class member's claim must come from the same event and the must make the same legal argument); and 4) adequacy of representation (the representative plaintiff will represent and protect the interests of the entire class.

This case is the first to try to assert a class action against all or most of the fraternity chapters on a given campus. Rather than attempt to accurately pursue the case against the chapter most responsible for the actions the plaintiffs complained of, they instead attempted to greatly broaden the case against 36 chapters. The plaintiffs similarly attempted to greatly broaden the number of plaintiffs by creating a subclass of plaintiffs to all of those who occupied property within 1,000 feet of any defendants' fraternity house. Judge Brick held that, "there is no reasonable way to identify all of those occupants."

The plaintiffs also sought a subclass of plaintiffs of all who encountered intoxicated people. Noting that this subclass was vague and overbroad, the Judge stated, "this subclass would include not just residents, but visitors, guests, those living beyond the South of Campus area, and the general public who may have visited the area and suffered an 'unwelcome encounter' with an intoxicated person." Such a subclass would be impossible to identify the judge held.

Finally, the Judge held that the plaintiffs could not establish the commonality necessary to maintain a class action, stating that, "the liability of each defendant would still require a level of individualized inquiry not amenable to class treatment."

We will provide updates in *Fraternal Law* on this important case if the plaintiffs appeal.

- Daniel J. McCarthy

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The Goal of *Fraternal Law* is to provide a discussion of fraternity law, but its contents are not intended to provide legal advice for individual problems of Greek organizations. The latter should be obtained from your attorney.

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