



Nonprofit Alert®

Alerting nonprofit leaders to key legal developments and responsive risk management steps.

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Faith-Based Initiatives:

President's Plan Inspires Faith & Fear

Legislation introduced last month formally puts President Bush's faith-based initiatives on the Congressional agenda, despite expected criticism about the constitutionality of the plan.

The bill, sponsored by Rep. J.C. Watts (R-OK) and Rep. Tony Hall (D-OH), includes incentives to stimulate charitable giving by permitting tax-free charitable IRA rollovers and by allowing non-itemizing taxpayers to take charitable deductions.

The more controversial part of the legislation would extend the 1996 Charitable Choice legislation to ensure that religious organizations are able to compete for federal funds in a broad array of federal programs. The 1996 legislation focused only on funding for welfare, social service, and drug and alcohol addiction programs. This new legislation would extend to over 100 federal programs, including juvenile delinquency, crime prevention, housing, job training, senior programs, child care, community development block grants, domestic violence and hunger relief funds.

Addressing a first order question for many religious

groups, the bill provides legislative protections for participating religious entities, permitting them to select employees based on religious hiring criteria, while also assuring that program participation remains open to all citizens.

➤ **Gammon & Grange is in contact with the white house office of Faith-Based Community Initiatives, which has invited us to address one of their priorities: to identify regulatory barriers to effective, efficient participation**

by faith-based organizations. Let us know if your organization has had difficulty with federal, state, or local regulations limiting or disqualifying your organization from participation. Email or fax us at:

➤ **GRG@GandGLaw.com.**

To learn more order Nonprofit Alert® Memo, Charitable Choice: Government Funding to Religious Social Service Providers, which concisely summarizes the faith-based legislation.

Congress Blocks Ergonomics

Business groups cheered and labor groups lamented Congress' repeal of OSHA's ergonomics standard last month, ending a long battle over federal regulations that had stirred controversy since OSHA first took up the issue nearly a decade ago.

The standards were intended to curb repetitive stress injuries that occur most often in employees who work on assembly lines or perform typing and data-entry tasks. But industry leaders had argued the regs would've put them out of business.

The standards had been widely criticized for their complexity (608 pages) and burdensome requirements of record keeping and program implementation. (See *NPA*, Dec. 2000). Proponents argued the rules were necessary to protect millions of workers employed in repetitive stress injury-prone jobs. Nonprofits were not exempt from the standards, nor were they relieved of shouldering the costs of implementation.

➤ **Review the workplace safety standards that apply to your organization with Nonprofit Alert® Memo, OSHA Requirements for Nonprofit Employers.**

« « « Say "Thanks" to Volunteers This Month » » »

April 22-28 is National Volunteer Week, a time when many organizations make a point to recognize and thank volunteers for their service. If you're looking for good graphics to use in drafting an appreciation letter to your volunteers, check out the online posters created by the Thanks Company. Four catchy designs herald the contributions of volunteers. The designs can be downloaded and edited or re-sized to include your organization's name, logo, etc. They're free for the taking at: <http://www.thankscountry.com/pages/posters.shtml>

Liability & Risk Management

May the Best EO Win: Competition Good for Vets

A little healthy competition never hurt anyone, not even an exempt organization, says a Missouri court in a ruling that allows two nonprofits to compete for members. Vikings USA and Modern Day Veterans (MDV), both nationally recognized tax exempt organizations, were in stiff competition for members in Missouri. MDV launched a campaign to actively persuade Vikings chapters to switch their memberships. MDV told Vikings chapters they could simply change their corporate name as registered with the Secretary of State's office but continue operating under their original corporate charters. Vikings claimed that MDV's membership campaign constituted tortious interference with contract and that MDV's statements were false and misleading. But the state appeals court disagreed. There can be no interference with contract if a party has a right to do the action of which the other party complains, the court summarized. Vikings chapters had the right to change their name or status at any time, as specifically provided under state corporation law, the court observed. *Vikings USA v. Modern Day Veterans*, Mo.Ct.App., So.Dist.Div.2 (12/22/00).

 **Rather than litigate, these competing organizations could have considered alternative dispute resolution. In either case, corporations that have chapters or affiliates should carefully review their chapter or affiliation agreements to ensure that trademark and trade name rights are clearly spelled out, and prudently protected.**

Donor Withdraws \$4.5M Gift, Citing Embarrassment

Because a failed plan to build an AIDS research center has become "a source of severe embarrassment," a wealthy donor is now requesting that Queens College return the \$4.5 million gift he gave the school in 1997 to help fund construction. According to *The New York Times*, the college's president promised to raise an additional \$30 million when the gift was made, but the campaign fell short; the president later resigned. The donor, Dr. Bernard Salick, reportedly informed the college that he was taking action because it became apparent that the project could not proceed, and that his scientific and philanthropic reputation had been damaged by the experience. He has, however, given the college the option of passing the money to another charitable organization.

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Nonprofit Alert is published monthly by the law firm of Gammon & Grange, P.C., which represents nonprofits nationwide. References in Nonprofit Alert in no way constitute an endorsement by Nonprofit Alert or by Gammon & Grange, P.C. Nonprofit Alert is distributed with the understanding that no legal, accounting or other professional services are rendered, and no attorney/client relationship is established. If legal advice or other expert assistance is required, the services of a professional should be obtained. ©1999 Gammon & Grange, P.C..

Lutheran Groups Scrutinized Over Insurance Sales

Lutheran Brotherhood, based in Minneapolis, and the Aid Association for Lutherans, based in Appleton, WI, have recently been hit with a rash of lawsuits filed by clients who purchased life insurance policies from the two groups. Both groups operate as tax-exempt 501(c)(8) fraternal benefit societies but are not affiliated with the Lutheran Church, although their membership is made up exclusively of Lutherans. Plaintiffs charge that the groups misled policyholders about the financial performance of their policies and used overly optimistic interest rate projections to predict the earnings potential of their policies. Most of the policies in question were sold during the 1980's when high interest rates made life insurance a less attractive investment vehicle than other investment tools at the time. The lawsuits have all been filed on behalf of Lutheran policyholders by one Tampa, Fla. law firm, following the lucrative settlement of similar cases against commercial insurance companies.

 **If the court certifies these cases for a class action lawsuit, as plaintiffs have requested, then years of litigation would likely ensue with millions of dollars hanging in the balance. This is an important case to watch, especially for nonprofits that offer investment services such as life insurance and annuities.**

Employees & Volunteers

Harassment Claim Creates Costly Defamation Suit

A former store manager won an \$11.2 million defamation case against the Safeway grocery store chain earlier this year when a jury found that the company conducted an inadequate harassment investigation, then publicly humiliated the manager by reprimanding him in front of other employees. According to his complaint, a female employee claimed she heard him make inappropriate sexual remarks about young women. Safeway assigned a human resources official to interview the complaining employee, but the official kept no records of the meeting. Another Safeway official later told the manager that a notice of the sexual harassment complaint would be placed in his permanent personnel file. However, this official made that statement in a public setting with several other employees witnessing the conversation. Subsequently, the store manager claimed he suffered ridicule, embarrassment and serious reproach from his co-workers. At one point, he attempted suicide and was eventually hospitalized for stress-related problems. He took disability leave but was later discharged after a 36-year career with Safeway. The manager then sued for defamation of character. *Tally v. Safeway, Inc.*, No. CAL-97-17458 (Md.Cir.Ct.).

 **Employers should have not only prompt, but careful and well documented investigation policies for dealing with harassment claims. The investigation process is critical and should be guided by competent counsel with due regard for the rights of both the complainant and the accused employee(s). For more guidance, refer to Nonprofit Alert® Memo, *Sexual Harassment Policy: Implement & Educate*. See back page to order copies for your leadership team.**

Taking Leave of FMLA: Must Sick Days Go First?

It's not necessary for an employee to use up all of his/her paid leave before invoking the additional leave time allowed under the Family and Medical Leave Act (FMLA), says the 11th Circuit Court of Appeals. The ruling arose from a lawsuit brought by a supervisor of a city agency who suffered from diabetes. After the supervisor failed to resolve a customer complaint, his boss questioned his performance. The supervisor explained that his diabetes "had been acting up," preventing him from conducting the investigation necessary to settle the complaint. When his boss questioned him further, the supervisor allegedly became irritated, walked out of the meeting, and left the workplace without permission. His boss then recommended termination, which the city finalized shortly thereafter despite a letter from the supervisor's doctor confirming his diabetes. The supervisor sued but lost in lower court because he had plenty of sick leave available, making him unqualified for FMLA leave, the court reasoned. On appeal, the 11th Circuit said employees are not required to exhaust sick leave or any other form of paid leave in order to qualify for FMLA coverage. Although various "unartful and unfortunate" language in the FMLA creates confusion on this issue, the 11th Circuit wrote, the statute plainly states that an employee who qualifies for FMLA leave (as the diabetic

supervisor did in this case) may take the full amount of leave permitted under FMLA, plus any additional leave the employer provides. The only variation to this rule is that the employee may choose or the employer may require both types of leave to run concurrently, the court ended. *Strickland v. Water Works & Sewer Bd. of the City of Birmingham*, 2001 WL 50433 (11th Cir., 2001).



FMLA continues to confound employers and employees alike. For tips on its practical application, order Nonprofit Alert® Memo, *FMLA Compliance*.

Tax-Exempt Issues

Association's Outsourced Magazine Produces UBIT

The Tax Court has ruled that the \$800,000 a police association earned from the publication of its official magazine was neither income from an exempt function nor royalty income and was, therefore, taxable as unrelated business income. Although the magazine was published annually by a company that held a "royalties and licensing agreement" with the police association,

NPA Highlight of the Month

Hospital Case Teaches EO/For-Profit Partnership Lessons

With millions of dollars at stake, the St. David's Healthcare System has filed suit against the IRS challenging the revocation of its 501(c)(3) status and seeking a refund of \$880,000 in taxes, penalties and interest. The case hinges on complex and precarious legal principles affecting any nonprofit that enters a partnership agreement with for-profit partners.

Formed in 1925, St. David operated as a charitable hospital until 1996 when it began a partnership with the for-profit health care conglomerate Columbia/HCA. The purpose of the arrangement was to improve the quality, efficiency, and cost effectiveness of the health care properties that both entities operated in central Texas. Both St. David and HCA were general partners, sharing profits proportionate to their respective percentages of partnership assets. The partnership was directed by a board of governors, half appointed by HCA and half appointed by St. David, with the chairman always appointed by St. David. Day to day operation of the health care facilities was handled by a management services company, which was a wholly-owned subsidiary of HCA.

The partnership agreement required all facilities operated by the partnership to comply with the IRS's community benefit standard, as mandated for hospitals operating as 501(c)(3) entities. That standard imposes such criteria as accepting Medicare and Medicaid patients, accepting all emergency patients without regard to their ability to pay, providing public health programs, and providing quality health care at reasonable cost. The agreement made this standard applicable even to HCA's for-profit facilities that were not previously subject to such criteria before entering the partnership agreement.

In 1998, the IRS audited St. David and eventually revoked its exempt status in a Technical Advice Memorandum (TAM) issued in 2000. That TAM has not been released to the public, so the IRS rationale for revoking the hospital's exemption is unclear. However, it can be deduced from St. David's complaint, that the IRS is questioning whether the arrangement results in private benefit and whether the nonprofit retains adequate control to protect its exempt status. St. David claims the refund on the grounds that the partnership is entirely consistent with its exempt status because the charity continues to operate exclusively for exempt purposes, and St. David continues to exercise control and direction over its activities. Further, St. David argues that the partnership satisfies the community benefit standard and results in no private benefit or inurement to private individuals or interests.



A ruling in this case isn't expected for several months, but it may ultimately serve to clarify the significant uncertainty that exists regarding partnerships between nonprofit entities and for-profit ventures—especially where a significant portion of a nonprofit's activities are undertaken by the partnership. These concerns are significantly increased if any nonprofit insiders stand to receive benefits (directly or indirectly) through the activities of the partnership. Read up on the pros and cons of various structural arrangements in Nonprofit Alert® Memo, *Subsidiaries & Nonprofit Affiliates*. Consult legal counsel if you are considering a joint venture or partnership with a for-profit enterprise.

the income was not exempt from UBIT as royalty income, the court said. The police association reviewed draft copies of the magazine before it was finalized and exercised some control over its content. This constituted more than the “passive involvement” that was allowable under the royalty exception to UBIT. *Arkansas State Police Assoc., Inc. v. Commissioner*, T.C. Memo 2001-38.

Executive Compensation on the Rise, Studies Show

While many nonprofit executives have seen substantial pay raises over the past few years, the median salary for a typical CEO of a nonprofit organization hovers around \$75,000, according to two new studies recently released by the National Center for Nonprofit Boards (NCNB) and the Society for Nonprofit Organizations (SNO). Higher paid CEO’s tended to work for international or national trade associations, foundations, and health care organizations. Groups that focused on religion, the arts or the environment paid lower CEO salaries, according to the surveys. Not surprising, the larger the nonprofit, the larger the CEO’s salary. For example, 38% of local nonprofits in one study reported CEO salaries less than \$50,000, but only 21% of national organizations in the same study reported lower.

➔ **Copies of the NCNB study are available at (800) 883-6262. The SNO study is available at (608) 274-9777. For help assessing reasonable executive salaries, order Nonprofit Alert® Memo, *Compensation Policies & Legal Guidelines*. Ordering info appears below.**

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State Rules & Regs

Maryland Church Property Qualifies for Exemption

Church property qualifies for tax exemption even though it’s zoned as open space, says the state court of appeals. At issue were 16.5 acres of land that joined additional acreage on which the Archbishop of Baltimore intended to construct a church. The county granted construction permits for the church but restricted development on the 16.5 acres, classifying it as “open space for agricultural use.” The tax assessor then levied property taxes since the area was not used “actually and exclusively” for religious purposes. But the state appeals court said the assessor did not prove that the church failed to use the acreage for religious purposes. It was just as likely, the court said, that the church could use the acreage in its natural setting to enhance religious worship. *Supervisor of Assessments v. William Cardinal Keller*, No. 85 Sept. Term, 1999 (Md.Ct.App., 2001).

➔ **This is a helpful case in an era of increasing constraint on property tax exemptions for nonprofits. Recognizing that “open space” can serve an entity’s exempt purpose contrasts with numerous tax assessor efforts requiring every parcel to have an exempt use.**

Give Blood, Get Time Off, Kansas Gov. Decides

Gov. Bill Graves has issued an executive order granting paid time off for state employees who give blood or donate organs or bone marrow. The Kansas Donor Leave program will give state employees up to 30 days of paid leave for organ donations, seven days for bone marrow donations, and 90 minutes for blood donations. The goal, he said, is to raise awareness and encourage participation in blood/organ donor programs throughout the state.

➔ **Although this isn’t your ordinary employee perk, it might just work in your organization, particularly if your organization supports medical or social causes that are helped by organ and/or blood donations.**