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Nonprofit *Alert*®

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

Supreme Court Ruling:

FMLA Leave Policy Trumps DOL Regs

Settling a discrepancy between statutory law and regulatory policy, the Supreme Court decided last month that the Family and Medical Leave Act (FMLA) takes precedence over Department of Labor (DOL) regulations that unduly expanded an employee's FMLA coverage.

FMLA provides up to 12 weeks of leave for employees with serious family or medical needs. To make sure employees are aware of this law, a DOL regulation (29 CFR §825.700(a)) required employers to give employees prompt written notice anytime their absences were considered FMLA leave. If an employer didn't provide such notice, then the employee's 12-weeks of FMLA leave was presumed to start at the time the notice was actually provided, *regardless* of how much prior leave the employee may have already taken.

Extension of Leave

In effect, the DOL regulation extended the statutory FMLA leave period when an employer failed to meet the notice requirement. This, the Court said, was "incompatible with the FMLA's remedial mechanism" and effectively "subvert[ed FMLA's] balance by entitling certain employees to leave beyond the statutory mandate." The Court said DOL's regulatory penalty had no relation to any damage an employee might suffer as a result of his/her employer's failure to provide proper notice. The regulation merely started the FMLA clock ticking, regardless of whether the employee might have acted in the same manner and taken additional leave with or without proper notice from the employer in the first place.

Facts of the Case

The case involved Wolverine World Wide, a shoe manufacturer. A Wolverine employee requested and received 30 weeks of medical leave under the company's own medical leave policy, which was significantly more generous than the 12-week period required by FMLA.Thereafter, the employee requested additional time off or part-time work, but Wolverine denied her request.

The employee did not return to work at the end of her 30-week leave period, so Wolverine terminated her employment.

The employee then filed suit, alleging that Wolverine failed to give her proper notice that her 30 weeks counted as FMLA leave, which therefore, entitled her to an additional 12 weeks of leave.

Surprisingly, the employee didn't argue that she would've

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Intermediate Sanctions Go Final

The IRS has issued final intermediate sanctions regulations that reflect few changes from the temporary regulations released last year.

The primary changes were in the definition of a disqualified person and in the safe harbor for organization managers. The final regs also include a statement clarifying that benefits obtained through theft or fraud are not compensation, but are excess benefits subject to taxation and penalties.

The changes resulted from hundreds of suggestions received from practitioners during a comment period and public hearing last year.

The intermediate sanctions regs prohibit "disqualified persons" (including directors, officers and others with substantial influence over the organization) from receiving excess benefits from the nonprofits they serve.

➤**Read more about the sanctions and how they apply to your organization with Nonprofit Alert® Memo, *Intermediate Sanctions Law.* above redacted.**

Liability & Risk Management

Nonprofit's Execs Caught in Alleged Ponzi Scam

A former Harlem Globetrotter and four other men were charged with civil racketeering and fraud in a costly Ponzi scheme they allegedly proliferated on their own employees at the Virginia-based nonprofit, Athletes for Jesus. The men held various leadership positions in the nonprofit or in affiliated churches, where they allegedly persuaded employees to invest large sums of money in a bank debenture program, promising high rates of return within one year. Some investors actually made money, then reinvested in the same program only to loose everything the second time around. The plaintiffs claimed the debenture program never existed; the money was never invested, and instead went directly to five leaders of the organization: a former member of the Harlem Globetrotters, the director of the nonprofit, a board member, and two associates of the organization. The former Globetrotter settled charges levied against him for $814,346. Another of the accused filed for bankruptcy, which stayed the proceedings against him. The remaining three men were held liable for fraud, conspiracy and civil racketeering and ordered to pay $8.75 million in damages. *Transition Inc. v. Austin,* No. 3:01CV103 (E.D. VA 2002).

Damage of $8.75 m. for fraud, conspiracy and racketeering

Warning signals could have sounded had the entity adopted appropriate internal controls. See Nonprofit Alert® Memo, *Conflicts of Interest Policy,* **available from Gammon & Grange. Ordering information appears on the back page.**

Errors & Omissions Clause Prevents Insurance Recovery for Nonprofit's Accounting Oversight

A federal district court in Minnesota says a nonprofit cooperative can't collect on its insurance policy for the losses it suffered when it repaid $750,000 in overcharges to one of its customers. The co-op inadvertently charged one customer higher prices for five years. The excess fees were then distributed as part of the co-op's dividends to members. An audit revealed the mistake, and the co-op agreed to repay the customer. But when the co-op filed the claim with its insurance company, relying on coverage under its errors and omissions policy, the claim was denied. A provision in the policy prohibited coverage on any liabilities arising from "the gaining of profit ... to which it [the co-op] was not legally entitled." The insurance company said this provision precluded coverage because the billing error resulted from the co-op's accounting mistake, which produced profit for the co-op. The co-op argued that the provision only applied when there was personal profit involved. But the court disagreed, and ruled that the exclusion applied anytime the insured acquired profit or advantage to which it was not legally entitled.

Standard nonprofit errors and omissions policies often contain clauses limiting coverage when profit is gained. Be sure you understand the extent of your policy's coverage—and any resulting liabilities that may *not* be covered like this one.

Employees & Volunteers

Employer Liable for Supervisor's Sexual Harassment

A California state agency has been found liable for sexual harassment that one of its supervisors perpetrated on an employee for several years, although the agency had no knowledge of the offending conduct nor had any way of discovering it. The employee was allegedly harassed by her supervisor for years, but she never reported it to management. Finally, she complained and the supervisor was eventually dis-ciplined, then allowed to retire. Afterwards, the employee filed a sexual harassment claim in state court against the supervisor and the agency. The agency defended by showing it had a policy in place to prevent and punish sexual harassment, but the employee did not take advantage of that policy. In federal law, this is usually an adequate defense for employers, but because this case was brought in state court, only California law applied. The court interpreted the California law to impose strict liability on employers for the actions of their supervisors and found the agency liable for the actions of the retired supervisor, even though it did not know of the harassment and did not have reason to know until the employee filed her complaint many years later. *Dept. of Health Services v. Superior Court*, 113 CalRptr.2d 878 (Cal.App. 2001).

State laws may impose more liability than federal discrimination laws.

Employers can't just stop at compliance with federal law, especially on issues of harassment and discrimination. As this case dramatically illustrates, some states impose much stricter standards than federal law. Employers must, therefore, identify and seriously consider the

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extent of their exposure under both federal and state law.

Short & Sweet: Court Says Claims Need Only Show Discrimination and Relief

The Supreme Court has overturned the 2nd Circuit Appeals Court, determining that employment discrimination complaints "need not contain specific facts establishing a prima facie case" but instead must contain only "a short and plain statement of the claim showing that the pleader is entitled to relief." The ruling is important because it clarifies an earlier landmark ruling in *McDonnell Douglas Corp. v. Green* that evaluated discrimination claims using a four-part test. That test included consideration of whether the plaintiff was a member of a protected class and whether an adverse employment action resulted. The Court said the test was still valid but should not be used to judge whether an otherwise valid complaint could proceed. During the pleading stage when the complaint is filed and motions to dismiss are typically heard, the Court said the plaintiff is only required to "give the defendant fair notice of ... the claim and the grounds upon which it rests." The Court's ruling permitted a 53-year old Hungarian employee's discrimination suit against his employer to proceed, although a lower court ruled that he "ha[d] not adequately alleged a prima facie case, in that he ha[d] not adequately alleged circumstances that support[ed] an inference of discrimination." *Swierkiewicz v. Sorema*, No. 00-1853 (Sup.Ct. 2/26/02).

Frequent Flyer Miles Aren't Employee Income

Settling a decades-long debate, the IRS announced last month that it has finally decided frequent flyer miles won't count as income to an employee.

Previously, the IRS had asserted that employees could be charged with an understatement of federal taxes if they did not report the receipt or use of frequent flyer miles or other promotional benefits attributable to their business or official travel. The IRS stressed that the new policy would not apply in cases where employee compensation is paid as travel or where travel benefits are used for tax avoidance. IRS Announ. 2002-18.

Note, however, that this recent decision does not apply to travel or other promotional benefits that are converted to cash. Those are most likely taxable income to the employee.

Tax-Exempt Issues

USA Act Gives Nonprofits New Service Initiative

Last fall, Congress passed the Unity in Spirit to America Act (USA Act) to establish a program naming national and community service projects in honor of those killed in the Sept. 11 attacks. Now, nonprofits are being urged to consider how theymight participate in the program. The Points of Light Foundation has been designated the lead organization to help coordinate project proposals among nonprofits. Government agencies and businesses may also participate. The Foundation will identify national and community service projects to name in memory of victims. Preference will be given to projects that advance the goals of unity and improve the quality of life in communities.

NPA Highlight of the Month

Appeals Court Sets New "Religious" Test for NLRB

The National Labor Relations Board (NLRB) has no jurisdiction over a religiously affiliated university, regardless of whether the NLRB determines the university lacks "substantial religious character." Even "the very inquiry by the NLRB into the university's religious character" is constitutionally prohibited, says a unanimous U.S. Court of Appeals for the D.C. Circuit. The ruling prevents the NLRB from recognizing a faculty union that had organized at the Catholic-affiliated University of Great Falls in Montana.

This case is significant for all religiously affiliated educational institutions because it delineates a new bright line test for exempting these schools and universities from NLRB jurisdiction, and thus, the formation of employee unions at these institutions. The three-part test exempts an institution if: 1) it claims to provide a religious environment; 2) is operated as a nonprofit; and 3) is either affiliated with or owned, operated, or controlled (either directly or indirectly) by a recognized religious organization. The test itself was suggested by an amici curiae brief submitted in the case by a group of educational associations.

The NLRB had attempted to recognize a chapter of the Montana Federation of Teachers at the university, after ruling that the "the propagation of a religious faith [wa]s not a primary purpose of [the university]" and that it, therefore lacked "substantial religious character." The NLRB based its ruling on a number of factors including the lack of curriculum focus on religion and the fact that less than a third of the enrolled students were Catholic. *Univ. of Great Falls v. NLRB*, No. 99-1415 (D.C. Cir. 2/12/02).

Since a 1979 Supreme Court ruling, the NLRB has decided on a case_by_case basis whether a religiously_affiliated school has a "substantial religious character" and whether it is subject to the NLRB's jurisdiction. However, this ruling curtails that power by substituting the three-part test because the court ruled the NLRB went "'beyond resolving factual issues' and engaged in inquiry into the 'religious mission' of the university." The court said "this three_part approach avoids asking how effective the institution is at inculcating its beliefs, an irrelevant inquiry that permeates the NLRB proceedings." Appeals will likely follow, so stay tuned.

For more information, go to the Points of Light Foundation web site, www.pointsoflight.org, and click on the box, "Sept. 11 Section."

IRS Approves Email Acknowledgments to Donors

Just in time for tax season, the IRS has confirmed that it will accept email receipts as proper acknowledgments of charitable gifts. The IRS released a general information letter last year indicating it would "probably" accept a charity's gift receipt sent via email to a donor for purposes of substantiating gifts over $250 and/or for satisfying the quid pro quo disclosure requirements of the tax code (*NPA*, Jan'01). But now, the IRS has adopted that statement as official policy in IRS Pub #1771. Charitable organizations aren't required under federal law to provide receipts for donations, but donors must have a written acknowledgment of their gifts valued at $250 or more in order to claim them as tax deductions. Most charities help donors comply with this rule by providing receipts. The IRS now says email "can speed this process and help charities provide better service to their contributors."

Pub #1771 is available on the IRS web site at www.irs.gov**. Nonprofit Alert® Memo, *Charitable Gifts: Receiving & Receipting*, available from Gammon & Grange, also provides helpful tips. See back page to order copies.**

Amounts Advanced to Subsidiary Won't Be UBIT

Funds that a tax-exempt hospital advanced to its taxable subsidiary won't be considered unrelated business income, the IRS has ruled, because the hospital helps the subsidiary provide health services to the community, and the hospital itself is exempt under 501(c)(3). The subsidiary's activities as a separate corporation are not imputed to the hospital, and the hospital does not exert undue control over the subsidiary. The hospital began the advance payments to the subsidiary when the subsidiary's membership dues and assessments fell short of projections. Since these revenues accounted for the subsidiary's primary income, the hospital agreed to make the advances to cover the subsidiary's operating expense shortfalls.

Since these revenues accounted for the subsidiary's primary income, the hospital agreed to make the advances to cover the subsidiary's operating expense shortfalls. The hospital did not charge the subsidiary any interest on the advance payments. This arrangement satisfied the IRS, resulting in a Technical Advice Memo that relieved both entities of any UBIT concerns. IRS TAM 2002208027.

FMLA Trumps DOL Regulation .....*(continued from p. 1)*

taken more or less or intermittent leave had she received the required notice. In fact, evidence in the case indicated her doctor didn't approve her return to work until long after her 30-week leave period ended, suggesting that she would've taken the same amount of leave with or without the FMLA notice.

Observing the disproportionate and inconsistent remedy produced by the DOL regulation, the Court objected to it as a "severe, across-the-board penalty" directed at all employers. The Court said it was in "considerable tension" with the FMLA's admonition encouraging employers to offer generous leave policies like Wolverine—in this case, even more generous than what FMLA required.

The Court concluded by invalidating the DOL regulation as contrary to the FMLA. Ragsdale v. Wolverine World Wide, Inc., No. 00-6029 (S.Ct. 3/19/02).

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