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Nonprofit Alert®

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

Inside This Issue:

Religious Hiring:
School May Terminate Non-Baptist Employees

A private Christian school in Maryland may hire and fire employees based on its religious preferences even where the employees' duties may not expressly involve religious functions, a state appeals court has ruled.

The case involved four employees of the Montrose Christian School, who previously won jury verdicts totaling more than $200,000 in damages after new management at the school terminated their employment (*NPA*, May '99).

Not Baptists, Not Members

The employees alleged they were all fired because they were not Baptists, nor were they members of the Montrose Baptist Church, which is affiliated with the school.

One employee worked as a teacher's aide; another served as a cafeteria worker, and two were secretaries in the school's front office. All four had been employed at the school for six to 18 years at the time of ermination.

The school said the four were terminated to implement changes in the school's administrative policy which became effective in 1996, shortly after a new principle assumed office.

All employees of the school who were not members of the church were discharged, with the exception of two janitors.

Purely Religious Functions

A county ordinance prohibits the selection of employees based on religion, except where employees are hired to perform "purely religious functions." But the appeals court ruled that this provision was unconstitutional.

The court reasoned that the "purely religious" limitation effectively nullified the exemption. "It is doubtful that any employees of religious organizations ... perform *purely* religious functions," the court surmised.

Therefore, the court chose to preserve as much of the ordinance as possible by severing the "purely religious" limitation. The remaining language t hen read, "it shall not be unlawful employment practice...for a religious corporation, association, or society to hire and employ employees of a particular religion."

It is worth noting that the court rejected the school's charitable immunity defense,

finding that it applied only in tort actions under Maryland law.

Since this case involved discrimination complaints arising from contract claims, the charitable immunity doctrine was unavailable, the court concluded.

Montrose Christian School Corp. v. Walsh, et. al., (4/12/01).

➢ **Federal discrimination laws provide similar protections for religious employers. To understand lawful ways to use these faith-based criteria in practices, read Nonprofit Alert Memo®, *Hiring & Firing: Rights of Religious Employers,* available from the law firm of Gammon & Grange, P.C. Turn to the back page to order. your organization's hiring/firing practices, read Nonprofit Alert Memo®, *Hiring & Firing: Rights of Religious Employers,* available from the law firm of Gammon & Grange, P.C. Turn to the back page to order.**

→✉✉✉ *Nonprofit Postal Rates Increase Next Month* ✉✉✉←

First class postage to mail a standard nonprofit letter will increase from 15.5¢ to 15.8¢, effective July 1. The periodical rate increases from 21.7¢ to 22¢. The increase marks the second time this year that nonprofit rates have risen. In January, rates increased by an average of 4.8% for nonprofits. Although the Postal Rate Commission advised against this latest rate hike, the U.S. Postal Service elected to implement the increase. Given the Postal Service's chronic losses, look for further rate hikes in the next 12 months.

Liability & Risk Management

When the Truth Finally Told: No D&O Insurance!

Directors and officers of two nonprofit nursing homes are not covered by the organization's liability insurance for claims of fraudulent misrepresentation filed against them. The directors and officers applied to a state agency for refinancing. Three years later, the nursing homes fell upon hard times and defaulted on the loans. The state then sued the directors and officers for breach of fiduciary duty and deceptive business practices, claiming they misrepresented the nursing homes' financial condition in order to qualify for refinancing. The organization's insurance policy contained a typical clause precluding indemnification for any claim "arising out of, based upon or related to the insolvency" of the nursing homes. The directors and officers tried to force insurance coverage by arguing the alleged misrepresentations occurred three years before the nursing homes became insolvent. But the Second Circuit Court of Appeals disagreed, ruling that the alleged misrepresentations were related, despite being made before insolvency, because they were "statements about the [nursing homes'] financial condition...intended to hide the fact that financial failure was looming on the horizon." This meant the officers and directors were *personally liable* for the claims filed against them and could not force insurance coverage. *Coregis Ins. Co. v. American Health Foundation,* No. 99-9300 (2nd Cir., 2/12/01).

This ruling is consistent with other decisions denying insurance coverage for directors and officers who have misrepresented material information or breached their fiduciary duty by failing to take appropriate action when their organizations faced insolvency. Educate your board about all their legal duties with Nonprofit Alert® Memo, *Directors' Nonprofit Legal Duties.* See back page to order.

Homeless Shelter Not Liable for Criminal Attack

A homeless shelter where a guest was injured by another guest is not liable for the incident, a Tennessee appeals court has ruled. To impose such a duty would create "an onerous burden" for the shelter, the court said. A guest at the shelter was injured while sleeping when another guest attacked him with a brick. A lower court decided the shelter owed no duty to protect against unforeseeable risks or criminal conduct perpetrated by third parties. The court of appeals agreed, finding that the foreseeability of harm must be balanced against the burden of preventing such harm.

Because the shelter did not charge for its services, it had no way of apportioning the cost of providing security. The court decided the burden outweighed the foreseeability of harm because the cost of security would have drained the shelter's resources for the homeless community. *Henry v. Bi-District Bd. of Urban Ministry,* No. M2000-01128-COA-R3-CV, Ct.App., Middle Sect. (2/23/01).

Although the doctrine of charitable immunity no longer exists in most states, the court's decision in this case is somewhat reminiscent of that doctrine. Don't rely on this kind of judicial balancing, however, to relieve your organization of potential liabilities. Discuss coverage with your insurance provider, and make sure you're protected against possible risks.

What, Me Supervise? Board Tagged with Negligence

The general manager of a nonprofit club allegedly criticized an employee in front of others, publicly stated that he intended to fire her, changed her duties to include janitorial work, assigned her to work nights and weekends with no additional pay, and excluded her from staff meetings. A majority of the club's board members knew of the conflict but took no official action. Two board members spoke informally with the club manager about the situation, but the problems remained unresolved. After nearly a year of such treatment, the employee began suffering emotional problems and took sick leave. The employee eventually filed a claim against the board for negligent supervision. She argued that the board:

- failed to properly control the manager;
- caused her emotional harm; and
- allowed him to operate outside the scope of his employment.

A trial court granted summary judgement for the board, but a Washington state appeals court reversed the ruling. The appeals court found that the board knew of the risk because a majority of its members were aware of the problem but took no action. The court said such an issue couldn't be decided on a summary judgement motion and sent the case back for further consideration. *Schraum v. Riviera Community Club,* No. 25003-9II, Wash Ct.App., Div. Two (2/9/01).

This is a good example of how board liability is being expanded through aggressive lawsuits, although it's unusual for a nonprofit board to face liability for negligent supervision, since such charges are generally levied only at upper management. Here, the board is defending against liability for a duty normally within the CEO's scope of authority. The lesson: knowledge imports duty. While boards generally don't operate on the front lines of personnel management, knowledge of negligence should be responsibly addressed. In egregious circumstances, it may be prudent for a board to take action, rather than defer entirely to the CEO. Read more in Nonprofit Alert® Memo, *Hiring & Supervision: Managing Employee Liability.* See back page to order copies for all your board members.

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Elder's Self-Packed Golden Parachute Fails to Open

Upon their retirement from the Word of Life Church in Florida, a husband and wife, who had served as elders of the church, sought to have church property and assets (worth an estimated $2 million) transferred to other corporations that they controlled. They accomplished the transaction by calling a meeting of church members and successfully leading a vote to change the church name. This effectively nullified the church's original articles of incorporation and by-laws. The couple then persuaded the congregation to vote in favor of dissolving the corporation and redistributing its assets among the corporations they controlled. A trial court initially upheld their actions, but on appeal, the transaction was stopped. A state appeals court ruled that the couple had acted in "ultra vires" or without authority and that the transaction was null and void. The court said the original church directors remained in control and remanded the case for further proceedings. *The Word of Life Ministry, Inc., et. al. v. Miller,* No. 1D99-2541 (1st Dist. Fla. App., 1/11/01).

Had the IRS been involved, it would likely have raised objections on grounds of "private inurement" and/or "self dealing," subjecting the individuals who received undue benefit to personal sanctions. Read more in Nonprofit Alert® Memo, *Intermediate Sanctions Law.*

Tax-Exempt Issues

Campaign Finance Reform Could Affect Charities

Two campaign finance reform bills currently circulating in Congress would prohibit charities, labor unions, and other nonprofit groups from running ads that mention a political candidate by name within two months of an election. One of those two bills would also prohibit direct mail and other forms of advertising that mention a specific candidate by name. Charity officials say the bills are unduly restrictive and hamper free speech. They're seeking to have charities removed from the list of those prohibited from running ads. "Issue ads" would not be affected; only those ads that mention specific candidates. The bills are currently before the House Administration Committee, which is scheduled to vote by next month.

Understand the current limitations on political advocacy with Nonprofit Alert® Memo, *Nonprofit Lobbying & Political Activity—Know Your Limits.*

Boat Gift/Sale Capsizes Under Tax Court Ruling

A businessman's excessive charitable deduction for the bargain sale of a pleasure boat to a nonprofit marine organization is not allowed, the Tax Court has ruled. The business man purchased the 1989

NPA Highlight of the Month

Summer Hires: Tips to Avoid Legal Traps

Summer brings a new crop of potential employees, known as "summer hires," to many nonprofit organizations. Typically, summer hires are high school or college students looking for part-time or full-time jobs with the earning potential or professional contacts to make their summers productive (or at least interesting). They can be a real boon to employers, especially nonprofits, because they provide a welcome source of energetic manpower at low cost. But they can also be an expensive burden if an employer falls into some of the legal traps that complicate summer hiring. The tips below can help avoid these traps:

Hiring Checklist - All summer hires must provide proper work authorization (especially foreign students), even if they've worked for your organization previously. They must complete and sign the standard I-9 form that all regular employees sign when starting work. You must report summer hires just as you would report any other new hires for state and federal employment reporting requirements under the Personal Responsibility Opportunity Work Act of 1996.

Income Tax Withholding - Summer hires must complete and sign state and federal income tax withholding forms (i.e. W-4's) like all other employees. You must account and withhold taxes in the same manner as for other employees. Most summer hires will not likely qualify for exemption from federal withholding laws, but some may qualify for state tax exemptions. Check the wage and hour laws in your state to be sure, and have all the necessary forms on hand to file in a timely fashion.

Child Labor Laws - Under most state laws, from June 1 until Labor Day, children aged 14 and 15 are legally allowed to work up to eight hours a day, for 40 hours per week, but they cannot work later than 9 p.m. Their jobs must be "age appropriate," meaning it's probably suitable for them to perform tasks under supervision in an office or retail environment, but it would not be appropriate for them to perform dangerous jobs at a construction site, for example. Between the ages of 16 and 18, summer hires may legally work any number of hours or days (subject to overtime and other wage and hourly laws) but not in any hazardous occupations or conditions. For instance, they're not allowed to operate heavy machinery. Special exceptions exist for some jobs, such as staff or counselors and summer camps.

Hiring Dependents - If you hire your own children, pay them only what other similarly situated and qualified employees are earning. This insures fairness, maintains employee morale, and hopefully avoids IRS scrutiny over excessive compensation or private benefit. If you still claim children as dependents for tax purposes, then you must provide at least half their support. Keep in mind that they shouldn't earn so much at their summer jobs as to jeopardize that tax benefit for you!

model Sea Ray Sundancer at a foreclosure sale and, while sailing the boat in Key West, was persuaded to donate the boat to the Institute of Marine Services (IMS). The businessman consulted a CPA firm, which advised him instead to sell the boat to IMS in a bargain sale transaction for $25,000 and claim a charitable tax deduction of $55,000 for the remaining value of the boat. The IRS objected, however, citing a significantly lower fair market value for the boat, cutting his charitable deduction in half. At trial, the Tax Court noted that IMS sold the boat for $35,000 only one month after the bargain sale occurred. The businessman was unable to refute the IRS's valuation. *Styron v. Commr.*, T.C. Summary Op. 2001-64 (5/2/01).

Aggressive marketing campaigns have significantly expanded the practice of donating cars, boats, and other vehicles to charity. But where the charity's sale is drastically different from the deduction claimed by the donor, the road could be bumpy. Reputable charities are not swayed by commercial counterparts. For more information read Nonprofit *Alert*® Memo, *Charitable Gifts of Property*.

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State Rules & Regs

Ohio Law Regulates "Unsupervised" Volunteers

Effective April 22, 2001, a new law in Ohio requires that all volunteers who have "unsupervised access to a child" must be informed that they could be required to provide fingerprints and/or undergo a criminal records check. The law does not *require* that fingerprinting or background checks actually be performed, but it is intended to deter prior offenders from volunteering. If an organization fingerprints or conducts a background check that reveals a prior conviction, then the organization is required to inform parents of all children who may be under supervision by that volunteer. OH S.B. 187.

Pennsylvania Proposes Tax Exemption on All Books

State legislators have introduced a bill to exempt all books from state sales taxes. The legislation is intended to insure that Bibles and other religious publications are not taxed, following a 1999 ruling by the state supreme court that held unconstitutional a long-standing tax exemption for religious publications. The bill's supporters say the only way to make the exemption fair and still comply with the court's ruling is to exempt all books. They also say passage of the bill will help bookstores in Pennsylvania be more competitive with Internet book sellers. Penn. H.B. 966

Textbooks, newspapers, and magazines purchased through subscriptions are already exempt from sales taxes in Pennsylvania. This legislation would add all books to that existing tax exemption.

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