

# Nonprofit *Alert*®

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

## Reasonable Accommodation

### Supreme Court Rules on ADA Standard

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Charity "Integrity"

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For the second time this term, the Supreme Court has handed down a major ruling on the Americans with Disabilities Act (ADA), this time addressing the controversial and confusing "reasonable accommodation" standard.

The ruling isn't a full victory for either employers or employees. Instead, the Court left open options that could ultimately swing the standard in either direction.

#### **Facts of the Case**

In this case, the Supreme Court ruled that it would be an undue hardship to require an employer to violate its seniority system to accommodate a disabled person. The case before the Court involved an employee of U.S. Airways who suffered from a back injury. The employee transferred from his cargo-handling job to a less strenuous job in the mail room. The mail room job, however, was subject to periodic seniority-based employee bidding.

Two years after the injured employee moved to the mail room, he was told that two other eligible employees were bidding on his job. He then asked US Airways to make an exception to the company's seniority system and deny bidding rights to those other employees, which would allow him to stay in the job as a reasonable accommodation to his disability.

US Airways refused, and he eventually lost his job to another employee. He then brought suit under the ADA, claiming discrimination and failure to grant him a reasonable accommodation. US Airways argued that it was unreasonable to require it to abandon its neutral seniority system in favor of the disabled employee.

#### **Split Decision**

In a 5-4 decision, the court rejected the employee's claim, but didn't wholeheartedly embrace US Airways's

argument either.

Instead, the Court described other situations where overriding a seniority system might be necessary to reasonably accommodate a disabled employee.

For instance, if special circumstances were present showing that a seniority system was not uniformly followed throughout a company and that exceptions were made for other reasons, then it might be reasonable to expect a company to override its seniority system and accommodate a disabled worker.

#### **Impact of the Decision**

The case represents the first time the Supreme Court has addressed

the reasonable accommodation standard of the ADA. In essence, the Court said the reasonableness of an accommodation goes beyond the effectiveness of the accommodation, meaning other factors must be considered.

However, employers may be better able to demonstrate "undue hardship" if a reasonable accommodation would require them to violate a uniform policy – such as a seniority system – designed to be fair to all employees.

*US Airways v. Barnett*, No. 00-1250 (4/29/02). @ N'al Law Journal, 5/6/02, p. 1; @ AHI Alert, 5/15/02, copy filed w/SJS.

### *New Law Protects Parsonage Exemption*

President Bush signed a new law last month that secures and clarifies a long-standing tax benefit to ministers, priests and rabbis.

Since 1921, Section 107 of the tax code has provided an exemption for ministerial housing.

That exemption came into question, however, when the IRS challenged the valuation method a minister used

to quantify his parsonage exclusion in a widely publicized case two years ago, *Warren v. Commissioner*.

The case eventually made its way to the 9<sup>th</sup> Circuit Court of Appeals where, earlier this year, the judges raised constitutional questions about the validity of the exemption

itself. (*NPA*, May'02).

That development stunned many observers, since neither the IRS nor the minister raised any constitutional issues; instead, their arguments only addressed valuation methods.

This new law seeks to preempt that appeals case now, with Congress dictating which valuation method the IRS will use: fair rental value.

The law amends the tax code to specify that a member of the clergy may claim a parsonage exclusion in an amount "not to exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities." It becomes effective for tax years beginning after Dec. 31, 2001.

## Liability & Risk Management

### ***What Not To Do: United Way Audit Offers Example***

United Way of the National Capital Area in Washington, D.C. released an audit last month that shows the organization did not break any rules or mismanage charitable funds. But the audit also revealed that the organization lacked proper controls and kept

poor financial records—problems its leaders say are now corrected. Public criticism from the organization's board led to a year-long controversy that

### **Seeking “transparency,” United Way released critical audit as a lesson learned.**

eventually culminated in the audit. Board members complained they were not informed of the organization's dealings, especially contractual obligations and employee expenses. The board alleged that \$85,000, intended to renovate restrooms for the disabled, had been misspent on new executive office furnishings. Competitive bidding and executive compensation were also at issue. The audit actually showed two significant failures: the organization lacked a competitive bidding process for large contracts, and it did not adequately document employee expenses. The board has now adopted new policies to correct both inadequacies. @ Chron of Phil, 5/16/02, p. 32.

**➔ The audit is notable not so much for what it revealed as for what it implies about United Way's approach to controversy. United Way's executives said they'd learned a valuable lesson about “the need for transparency.” In releasing the audit, that's exactly what the organization was attempting to accomplish. Find out how an audit could help your organization achieve the same goal in Nonprofit Alert® Memo, *Annual Audits: Vital Risk Management*. Turn to ordering instructions on the back page.**

### ***Director's Service Depends on Incorporation Terms The “Ayes” Don't Have It, If The Documents Say “No”***

Here's an important reminder to closely check Articles, Bylaws, and state law before taking decisions affecting the governance of an organization. Board members who served more than ten years on a church's board of directors continue serving until their successors are “elected and qualified,” regardless of a state statute limiting the term to five years, a Louisiana Appeals Court has ruled. The reason: the church never formally adopted bylaws. The

church had actually existed for more than 50 years, but was only incorporated in 1990. Ten years later, a dispute erupted between two factions in the church. One side, led by the pastor, held a secret meeting at which they claimed to have replaced board members and amended the church's bylaws. Another group organized a different meeting of the church's full membership and elected a new board. The pastor's group claimed their board members were legitimate because a state statute said nonprofit directors could not be elected for a single term of more than five years. Since the church never adopted bylaws or followed any corporate formalities for electing new board members, the pastor's group argued that the original directors ceased to have power five years after the church was incorporated when their terms legally expired under the state statute. The court disagreed, however, interpreting state law to confirm that unless the governing documents provide otherwise, the board members remain in office until their successors are chosen. Because there were no such contrary documents, and since four of the original board members were still active in the church and were present at the full membership meeting when other directors were elected, the court said this represented the only legitimate selection of a new church board. *Mt. Gideon Baptist Church v. Hollins*, No. 2001-0749 (LA Ct.App. 1st Cir., 2/15/02). @ NP Issues, 2/02, p. 1.

**➔ Most state laws permit nonprofit directors to remain in office until their successors are chosen if their Articles and Bylaws so provide, especially when sensitive governance questions loom, take no action without first refreshing your knowledge of what your Articles and Bylaws currently state; and if there is ambiguity, consult counsel to review state law and when organizational changes necessitate amendments, observe all corporate formalities in making adjustments.**

## Employees & Volunteers

### ***Re-hire Retaliation: FMLA Represses Refusals***


The Family & Medical Leave Act (FMLA) even covers a previous employee if that person later attempts to get rehired by the same employer, the 11<sup>th</sup> Circuit has ruled. The case involved a BellSouth employee who took FMLA leave when he became ill. He eventually resigned, but four months later, reapplied for a new job with BellSouth. The staffing manager who considered him noticed that his old employment file was labeled “not eligible for rehire.” When she inquired further, she was told he took a lot of FMLA leave and had bad attendance, poor performance, and an abusive temperament. The employee filed suit against BellSouth, alleging an FMLA violation, based on that labeling. A lower court

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rejected his claim because the FMLA protects only employees, and since he was not an employee at BellSouth when the company refused to rehire him, the court said he had no claim. On appeal, the 11<sup>th</sup> Circuit reversed, finding the term “employee” was ambiguous in FMLA language. The court reasoned that the law must cover former employees; otherwise, those individuals would have no remedy if their former employers retaliated against them after they took FMLA leave. The court concluded that basing a rehire decision on a former employee’s past use of FMLA leave was precisely the kind of discrimination the law was intended to alleviate. *Smith v. BellSouth Telecommunications*, 2001 WL 1502528.

 **Confused about FMLA requirements for your employees? Read Nonprofit Alert® Memo, *FLSA: What It Means for Nonprofit Employers*, available from Gammon & Grange. See back page for ordering instructions.**

### ***Supervisor’s Racist Remarks Indicate Discrimination***

A supervisor’s alleged statement that he would “get you “n\*\*\*\*\*s” out of here,” is enough direct evidence of discrimination to merit a trial on the issue, a federal district court in Maryland has ruled. Two African-American employees of a

nonprofit home for disabled children brought suit alleging they were wrongfully terminated based on the racially motivated actions of one white male supervisor. The nonprofit employer argued they were both fired for sleeping on the job, but the court allowed their claims to proceed because the supervisor’s racial slur indicated his intent to remove plaintiffs from their jobs based on his discriminatory attitude. Three other African-American employees also brought suit alleging hostile work environment and discrimination, but the court dismissed those claims for lack of direct evidence showing any “nexus” between the supervisor’s remark and employment actions that affected their jobs. *Oladokun, et. al. v. Grafton School*, No. 2001-0550 (D.MD, 2002). @ NP Issues, 2/02, p. 8.

 **One offensive remark is usually regarded as an isolated event, not evidencing discrimination unless there’s a direct connection between it and an adverse employment decision. Nonprofit Alert® Memo, *Employment Discrimination: Steering Clear in the Nonprofit Organization* offers guidance to prevent employment discrimination. See back page to order.**

## ***NPA Highlight of the Month***

### ***IRS Finalizes Rules on Sponsorship Payments***

With growing reliance on corporate donors which sponsor exempt organizations’ events and activities, the IRS began an effort two years ago to clarify rules governing the tax treatment of those sponsorship payments. That effort has just culminated in the issuance of final regulations covering a wide array of corporate sponsorship issues from exclusive provider contracts to web site endorsements.


The new regs do not alter existing tax laws, but clarify how and when the IRS will to assess unrelated business income tax (UBIT) on exempt organizations that receive income from corporate sponsorship agreements. For instance, the regs provide that a “qualified sponsorship payment” does not trigger UBIT, but if, in return for its payments, the corporation receives a “substantial return benefit,” the payment cannot be a qualified sponsorship payment. Thus, if a corporation offers a “sponsorship” but in return receives access to a mailing or attendance list for marketing, or the charity agrees to encourage purchase of particular products or advertise product sales, the arrangement is not “sponsorship,” but advertising.

Examples of clarifying aspects of the final regulations include:

- *§513(i) Safe Harbor* - The new regs eliminate the §513(i) ceiling of \$79 for what’s considered “insubstantial benefits” and replace it with a formula that safe harbors any amount below two percent of the sponsorship payment. In other words, if the value of any return benefit to the corporate sponsor is less than two percent of the sponsorship payment itself, then the IRS won’t consider the benefit to be substantial, thereby avoiding UBIT liability.

- *Web Site links* - An exempt organization’s web site may contain links to a corporate sponsor’s web page so long as the exempt organization does not endorse the corporate sponsor or its products/services.

- *Exclusive Providers* - Granting a corporate sponsor the right to be the sole sponsor of an event does not of itself constitute a substantial return benefit to the corporate sponsor. However, if an exempt organization also agrees not to sell or purchase any products or services that compete with the corporate sponsor, then a substantial return benefit does occur and the organization likely incurs UBIT liability on the corporate sponsorship payment. T.D. 8991. 67 F.R. 20433-20441. @ Tax Practice, 5/10/02, p. 124; EOIR Wkly, 5/6/02, p. 31; Chron of Phil, 5/2/02, p. 36

 **The regulations are effective April 25, 2002 and retroactively apply to transactions solicited or received after December 31, 1997. Charities with existing sponsorship agreements should review the language of all agreements to make sure any benefits a corporate sponsor receives are narrowly defined so that any presumption of “substantial benefits” is negated. Many arrangements can be easily modified and clarified to fit within the various UBIT exceptions, so consult with experienced nonprofit counsel to evaluate how these arrangements can be structured.**

## Tax-Exempt Issues

### *Court Nixes Tax Break for Religious Groups*

A federal district court in Louisiana has ruled that state sales and use tax exemptions, provided exclusively for camp and retreat facilities operated by religious organizations, are unconstitutional. As such, the court granted a preliminary injunction and declaratory relief requested by the ACLU to enjoin the state from recognizing the exemptions. Citing the historic precedent of *Lemon, Texas Monthly v. Bullock*, among other cases, and other religious liberties cases, the court said the Louisiana tax exemptions benefitted only religious groups and were, therefore, unconstitutional. The ACLU had challenged the tax exemptions as “narrowly drawn to benefit only religious and faith based taxpayers,” but the state argued the exemptions did not “attempt to establish, sponsor or support religion.” The court sided with the ACLU, saying nothing in the legislative record indicated that the exemptions had been drafted as a secular legislative policy intended to benefit nonreligious groups the same as religious groups. *ACLU v. Crawford*, No. 00-1614 (U.S. Dist. Ct., E.D. La, 3/21/02). @ Ex Org Tax Review, 5/02, p. 290.

➔ **The question here is whether giving the tax preference, the government is seeking to favor only religious groups and is thereby impermissibly entangling itself with religion. This is another in a line of recent cases which further the application of legal theories that significantly curtail exceptions that apply to religious groups. Some states have successfully defended such exemption statutes as part of a broader legislative determination – not just focused on religious groups – and some have revised their statutes to encompass both religious and secular groups. In either case, it is important for secular and sectarian nonprofits to understand how state taxes – particularly sales, use, personal property, and real estate – apply to them.**

### *Merger Won't Affect Charity's Pooled Income Funds*

A public charity planned to merge two of its pooled income funds, but sought review by the IRS to make sure the resulting fund would not trigger taxes or result in a loss of exemption. The merger would involve transferring proceeds from the first fund into the second fund, then dissolving the first fund. The IRS said the merger was permissible and would not endanger the second fund's exempt status as a qualified pooled income fund. The charity also sought IRS advice on what rate of return it should use to determine the value of subsequent contributions to the merged fund. The IRS said the rate of return should be determined as if both funds had been combined for all tax years in which they are actually combined, plus the three prior tax years. @ Ex Org Tax Review, 5/02, p. 211.

➔ **Pooled income funds offer a unique giving opportunity for donors to give and receive at the same time. Although these funds have fallen from favor in recent years because of the economy, they still remain a viable source of long term fundraising for charities.**

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