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# Nonprofit *Alert*®

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

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## Volunteer Files Retaliation Lawsuit

A Nebraska doctor, who held a volunteer faculty position at the University of Nebraska Medical Center, claims he was term-inated from a volunteer position in retaliation for his involvement in an abortion rights case that generated much national attention.

The doctor has filed suit against the university, seeking injunctive relief, rein-statement to the volunteer position, plus other unspecified damages. He claims the university's termination of his volunteer status harmed his professional reputation and violated his constitutional rights to free speech.

The case is unusual because it pits a volunteer against a nonprofit with the volunteer asserting employee-like rights—something not often seen in litigation involving tax-exempt entities. Since volunteers don't generally enjoy employ-ment rights, this case presents ground-breaking issues for nonprofits to consider.

In a complaint filed on behalf of Dr. LeRoy Carhart, the Center for Reproductive Law and Policy argues that the university came under political pressure to dismiss Carhart after he challenged the state's ban on partial birth abortion. That challenge led to a Supreme Court ruling last summer, which struck down Nebraska's ban on partial birth abortions. *Steinberg v. Carhart*, No. 99-830, 192 F.3d 1142, aff'd (U.S. 2000).

According to Carhart's complaint, he filed the partial birth lawsuit in June 1997. In October 1997,

***The case is unusual because a volunteer is asserting employee-like rights against a nonprofit.***

the university appointed him volunteer adjunct assistant professor in the Department of Pathology.

Carhart had developed a relationship with the university before being appointed to the volunteer position, however. He sometimes provided fetal tissue to researchers at the university's medical center, according to published reports "The volunteer professor position was given to him by the university in recognition for his contribution to their research," explained one of Carhart's attorney's, Jerry Hug.

Carhart never received any monetary remuneration. The position was purely an honorary appointment.

University officials said Carhart's termination came as a result of restructuring and reorganization within the medical center. His volunteer position was simply eliminated, along with 29 other such volunteers. Those scheduled for termination were given the opportunity to request another volunteer position, but Carhart never submitted a request, according to a spokesperson.

**Carhart's claims succeed, it would significantly expand volunteer liability, particularly among foundations, universities and other nonprofits that rely on "honorary" volunteers. It could also define "termina-tion rights" of emeritus board members or any volunteer position that involves some positive public recognition.**

### →→→IRS Releases CPE Text for 2001 ←←←

The IRS recently trimmed its primer for training agents who regulate and audit tax exempt organizations. The new *Exempt Organizations Continuing Professional Education Text* now includes only 10 chapters com-pared to last year's 21 chapters. Topics of importance to your nonprofit: (1) *Limited Liability Companies*; (2) *Private Benefit Under IRC 501(c)(3)*; and (3) *State Charitable Solicitation Statutes*.

➢**The IRS has also published a revised Publication 598, which addresses unrelated business income tax. These publications are available at www.irs.ustreas.gov/forms_pubs/pubs.html.**

## Liability & Risk Management

### *Contract Cancels Nonprofit's Liability Protection*

A nonprofit agency that offers free services to troubled teens is not covered by a state volunteer protection law, a Colorado appeals court has ruled. The ruling leaves the agency open to a liability claim filed against it by a teen who was allegedly injured by the agency's negligence. A trial court had originally said that the agency was protected because it qualified as a volunteer. But the appeals court disagreed. Colorado law says that a person, corporation, partnership, or association that serves young people, cannot be liable for injuries (except for willful acts or omission) if the entity provides such services without compensation or expectation of compensation. In this case, the agency received a state grant to cover its expenses and pay administrative salaries. Although most of its staff were volunteers, the agency had a $59,000 contract with the state to provide social services. The appeals court ruled that the contract was compensation, meaning the agency could not fit the state's definition of volunteer protection coverage. *Gilmore v. Concerned Parents of Pueblo* (Ct.App.Div. 5, 10/26/00).

**Check state law to determine if your organization is covered under a volunteer protection statute. As this case demonstrates, immunity turns on specific state law and on the facts and circumstances of your situation. Most volunteer protection statutes are drafted with individual volunteers in mind, not organizational entities like the agency in this case.**

### *Company Policy on Incriminating Photos Upheld*

Wal-mart, Inc. was justified in firing one of its photo lab employees when she turned incriminating photos over to the police, rather than report the photos to her supervisor, a federal jury in Omaha has ruled. The photos showed possible evidence of child abuse, which under state law must be reported to proper authorities. However, Wal-Mart's corporate policy directs employees to give such materials to their supervisors. Wal-Mart then releases material to law enforcement agencies through a management team. Employees may go directly to management officials above their supervisors if they are uncomfortable turning over potentially illegal materials to their supervisors. In this case, the employee stated she would not comply with the policy and contacted police herself. She gave police the questionable photos, which prompted a criminal investigation. The child shown in the photos was eventually placed in foster care. Despite praise from the police department for her efforts, the employee violated Wal-Mart's customer confidentiality and supervisor notification policies. Jurors decided this gave Wal-mart ample justification to terminate her employment. Her suit for wrongful termination against Wal-Mart was dismissed. *Gasper v. Wal-Mart, Inc.*, No. 8:CV99-45 (U.S. Dist.Ct.Neb., 1/12/01).

**Become familiar with the child abuse reporting laws in your state, and train your employees accordingly. Here, Wal-Mart was able to successfully defend a wrongful termination suit by having in place a thoughtful and informed policy that balanced customer privacy concerns with state child abuse reporting laws. Review Nonprofit Alert® Memos, *Child Abuse: A Legal Overview* and *A Summary of State Laws*.**

### *Local Affiliate Beats National in Property Dispute*

The Miami, Fla. affiliate of the North American Islamic Trust (NAIT), a national religious organization, has rights to property titled in NAIT's name, even though the local affiliate borrowed money from NAIT to purchase the property. NAIT had argued that it owned the property because title was in NAIT's name. The local affiliate argued, however, that NAIT only held title as collateral on the loan it took from NAIT to purchase the property in the first place. Purchase price of the property was $640,000. At the time of purchase, the local group transferred $50,000 of its own money to NAIT, then signed a $170,000 promissory note to NAIT. The balance of the purchase price was contributed by NAIT. Later, after the local group paid off the note, NAIT refused to release title to the property, claiming that it held the title in "trust." A trial court ruled that the local group never intended to put the property in trust and NAIT only held the property as collateral. On appeal, the trial court's ruling was upheld, and NAIT was ordered to turn over title to the local affiliate. *The North American Islamic Trust v. The Muslim Center of Miami,* (Ct.App., 3rd Dist., 11/1/00).

**An explanatory sentence in the property's financing documents could have avoided two years of expensive and rancorous legal proceedings.**

## Employees & Volunteers

### *Circuit Courts Balk at DOL's FMLA Regulations*

The 11th Circuit U.S. Court of Appeals has rejected a regulation promulgated by the Department of Labor (DOL) that effectively extended protection under the Family & Medical Leave Act (FMLA) to ineligible employees. Under the FMLA, only employees who have worked at least 1,250 hours during the preceding 12 months qualify for leave. This case involved an employee for the BellSouth corporation who requested FMLA leave but had not worked the required number of hours.

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BellSouth didn't respond to her request until a month later, informing her that she was ineligible because she lacked the requisite number of work hours. A separate DOL regulation requires employers to respond to FMLA leave requests within two business days. If the employer fails to advise the employee of his/her ineligibility during that period, then the employee will be deemed eligible for FMLA coverage, the regulation says. After BellSouth refused to grant her FMLA leave, the employee brought suit claiming that BellSouth's failure to inform her of eligibility within the time required by the DOL regulation made her, in fact, eligible for the leave. The 11th Circuit resolutely disagreed. Upholding a lower court's ruling, the 11th Circuit said the DOL regulation was "unconstitutional to the extent that it converts ineligible employees into eligible employees, contrary to the express language of the FMLA." The court then chastised the DOL for its "administrative hubris" and said the agency had gone too far in "creating a gap into which it can wedge its policy preference." *Brungart v. BellSouth Telecommunications, Inc.*, 231 F.3d 791 (11th Cir., 2000).

**The 11th Circuit now joins the 7th Circuit in rejecting this controversial DOL regulation. Whether the DOL will revise its regulations remains to be seen, however. In the meantime, employers should promptly notify any ineligible employee within two business days of their request for FMLA leave. Review Nonprofit Alert® Memo, *FMLA Compliance,* for more details.**

### *Football Tickets Cause Fumble on Employee Taxes*

Skybox seating...tickets to the big game...free parking...what sports fan doesn't salivate at the thought of these fringe benefits from their employer? They may be highly coveted benefits, but they're also taxable income to the recipients, as three enterprising brothers discovered. Jim Whittington established the Fountain of Life (FOL) evangelical organization and hired his two brothers, Ray and Larry (both ordained ministers), as officers and directors. The three collected salaries, housing allowances and other benefits from FOL. In 1995 and 1996, the IRS determined deficiencies in Ray and Larry's income tax filings and brought suit against them on a number of issues, including the receipt of season tickets to East Carolina University football games, purchased by FOL. Records also showed that FOL made scholarship pledges to the university on behalf of Ray and Larry during two consecutive years. The IRS claimed the brothers failed to include the football tickets and scholarship pledges in their taxable income. The Tax Court agreed, finding that "a third party's payment of a taxpayer's personal expenses is income to the taxpayer." *Whittington v. Commissioner of Internal Revenue,* T.C. Memo 2000-296.

**Besides the apparent tax chicanery involved here, these kinds of fringe benefits are generally taxable to employees, with the exception of certain notable exemptions contained in the tax code. Learn what fringes are/aren't taxable in Nonprofit Alert® Memo, *Employee Benefits: A Summary for Nonprofits.***

## Tax-Exempt Issues

### *NPA Highlight of the Month*

# Failed Office Supply Scam Targeted Nonprofits

A shrewd marketing scheme that targeted nonprofits shut down last month after agreeing to pay $374,000 in consumer redress to settle claims brought by the Federal Trade Commission (FTC). Laser Express of Tennessee, Inc. and its owner, Jeff Richfield, allegedly used deceptive practices to sell office supplies and ink toner to nonprofits and businesses. According to the FTC, Laser routinely sent unordered supplies, shipped merchandise after organizations refused to place an order, and sent additional unordered goods. Laser would claim that an employee had ordered the goods, then find someone within the organization to accept the shipment. The FTC also alleged that Laser conducted deceptive telemarketing by making false and misleading statements during sales calls, which were intended to induce organizations into ordering office supplies. For example, Harold Kirtz, Senior Litigator for the FTC's Southeast region, explains that Laser telemarketers often identified themselves as "your regular supplier." Laser's prices were substantially higher than market prices, but Laser representatives allegedly told nonprofits the higher prices were because Laser's product lasted two to three times that of ordinary products, a completely false statement. The FTC settlement permanently bans Laser and its owner from engaging in the telemarketing or sale of office supplies. The following names under which Laser also did business are included in the ban: Data Supply International, Cartridge Express Limited, International Cartridge Supply, International Data Supply Company, and International Supply Company.

**Think your organization couldn't be duped by such a scheme? Think again—in this case, more than 3,000 businesses nationwide, including at least 300 nonprofits, were taken in by Laser's deceptive marketing, reports the FTC's Harold Kirtz. His best advice for avoiding these scams: "Don't buy from a cold call." Reusable items easily ordered by phone such as office supplies and cleaning products often spawn these types of scams, he says. Check out the FTC web site at http://www.ftc.gov for more details on this case and other ongoing scam investigations.**

## *Foundation Partners With Charity on Scholarships*

A private foundation proposed to make grants to a public charity in support of a scholarship program for deserving students, but the foundation requested the IRS to determine whether these grants would be "taxable expenditures." The reason for the inquiry was that private foundations are subject to specific requirements under the tax code, which mandate that any scholarship funds given by foundations (1) must be made on an objective and nondiscriminatory basis, (2) must not be made to family members of the foundation,
and (3) must be approved by the IRS in advance. If such scholarships don't meet these criteria, then they are considered taxable expenditures of the foundation. In this case, the scholarship program was completely run by the public charity. Scholarships were to be awarded on the basis of scholastic achievement and leadership. No member of the foundation would be eligible. On this basis, the IRS ruled the foundation's grants to the public charity were not taxable expenditures and did not result in self-dealing on the part of any foundation members. IRS PLR 200102054.

## *Investment Help: An Exception to Self-Dealing Rules*

Payment of fees for management and investment services to a "disqualified person" will not result in self dealing for two foundations, the IRS has ruled. The two foundations planned to use a subsidiary's trust department for financial services, including investment advice and management. The foundations believed they could better focus on reviewing grant applications by using the subsidiary's trust department, rather than an outside entity. Both foundations and the subsidiary had certain officers, directors and employees in common. The fees the subsidiary planned to charge were competitive with commercial rates, including a 10% discount that the foundations would get as part of the subsidiary's standard discount for nonprofits. The IRS determined that the subsidiary was a "disqualified person" under the definition contained in the tax code, but ruled that the services it was to provide were exempt under the tax code definition of self-dealing. IRS LTR 200050047.

**A section of the tax code provides an exception for "personal services" that are reasonable and necessary to carry on an exempt purpose.**

**It was this exception that led to the IRS's ruling. Find further information on self-dealing rules in Nonprofit Alert® Memo, *Private Inurement: Essential Do's & Don'ts.***

# State Rules & Regs

## *Telemarketers Beware: Calls Could Cost Big Money*

A New Jersey lawmaker has introduced a bill in the state assembly that would fine telemarketers $2,000 for every call they make to numbers on a "no-call" list. The list would consist of consumers who have requested telemarketers not to phone them. Currently, the Direct Marketing Association (DMA) maintains such a list, but telemarketers are under no obligation to observe the "no-call" policy. The New Jersey law would make the policy mandatory for all telemarketers and would permit consumers to place their numbers on the list simply by calling a toll free number maintained by the state. Several other states, including Connecticut and Idaho, have considered similar bills. N.J. Assembly No. 3028 (intro. 12/7/00).

**If your organization relies heavily on telemarketing, these state efforts will likely limit your efforts. Consider this legislation a clear signal to start looking for alternate methods of contacting consumers.**

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