



Nonprofit *Alert*®

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

Inside This Issue:

Liability..... 2

- ADA & Web Sites
- Drug Test Damages
- \$4-M Grant Dispute

Employees & Volunteers.... 2

- Joint Pay Problems

Tax-Exempt...3

- Stock Donations
- Minister's Taxes
- Related Nonprofits
- No Exemption
- Nonprofit Mail

State Regs.... 4

- Property Taxes in Maryland & Nebraska

Plus...

NPA Highlight of the Month:

FMLA Reaches Small Employers

— page 3 —

➤ Charitable Solicitation

Tenth Circuit Nixes Bond Requirement, But Okays Fundraising Disclosure

In a case closely watched by nonprofit groups nationwide, the Tenth Circuit Court has ruled that several requirements imposed under a Utah charitable solicitation law are unconstitutional, particularly a provision that required

professional solicitors to post a \$25,000 bond before conducting charitable solicitations in the state. The court left other parts of the law alone, however, prompting experts to predict that additional legal challenges are coming.

The case involved American Target Advertising (ATA), a direct mail company hired by Judicial Watch, a conservative Washington, DC group, to conduct fundraising. When Justice Watch filed for solicitation in Utah, the state insisted that ATA register as well. ATA objected, arguing a violation of free speech and due process because the law was not "narrowly tailored" to protect the public without infringing on the rights of charities. A lower court ruled in Utah's favor (*NPA*, Oct. '98). But the Tenth Circuit disagreed, finding that the large bond requirement had a "chilling" effect, which unconstitutionally restricted free overall activities is spent on influencing legislation. But the IRS has never given the

"substantial part" test a quantifiable definition. This leaves many charities uncomfortable about speech. The court also struck down two additional parts of the law for vagueness. One provision allowed the Director of Utah's

Consumer Protection Division to request "any additional information the division may require" from out-of-state charities, but the court disapproved this "unbridled discretion." The other provision permitted Utah to deny solicitation to any individual or organization that failed to "reasonably supervise" its agents, but this was too broad and undefined, the court said.

The court upheld several other parts of the law, however, including requirements that consultants must obtain a state license, file annual financial disclosures, and pay an annual registration fee of \$250. *American Target Advertising v. Francine A. Giani*, No. 98-4158 (10th Cir., 1/13/00).

"The [bonding] requirement imposes a sizeable price tag upon the enjoyment of a guaranteed freedom. . . . Through the registration, disclosure and fee requirements, the statute provides less intrusive means of fraud prevention. The chilling financial reality of the bond unnecessarily interferes with First Amendment freedoms." —*Judge Deanell R. Tacha*,

➤ **ATA says it will appeal to the Supreme Court in hopes of having all parts of the Utah law overturned. In the meantime, more legal challenges to state laws like this one are likely, following the mixed outcome of this case. The complete ruling is available at <http://www.kscourts.org/ca10/>**

--- Where in the World ... Is the Best Place for a Nonprofit? ---

Austin, Chicago, Indianapolis, Los Angeles, Minneapolis, New York, Orlando, Phoenix, Seattle, and Washington, D.C.

According to Arizona State University's Nonprofit Management Institute, those are the top ten cities for starting and developing a nonprofit (listed alphabetically), based on many factors, including government regulations, growth, and availability of technology training. Read more at <http://www.asu.edu/xed/npmi/>.

Liability & Risk Management

Disability Act Could Stymie Web Site Designs

As if web designers don't have enough to worry about these days with security concerns and the threat of hackers always present, the Americans With Disabilities Act (ADA) may now apply to web sites, requiring them to be reasonably accessible to disabled users. The Justice Department has already indicated it interprets the ADA as applying to web sites. And last month, Congress held hearings on the issue and may consider legislation. The action comes after the National Federation of the Blind filed a lawsuit against America Online last fall, alleging that AOL's software is inaccessible to blind users. The Federation claims AOL's icons and graphics cannot be read or translated by "screen access programs," web browsing software that transforms screen text into spoken words or Braille that blind users can understand. The case is still pending, but Congress heard advocates for the disabled describe various ways that web sites can be built to accommodate blind and disabled users. Business leaders asked Congress not to enforce the ADA or any new legislation against web sites presently, since the industry is already moving to make the Internet more accessible. *N'al Federation of the Blind, Inc. v. America Online, Inc.*, CA 99-12303-EFH (D.Mass., filed 11/4/99).

➔ **According to experts, it's not graphics per se that cause problems for disabled users, but the design of systems that rely solely on graphics. It's too soon to speculate what federal regulations could eventually address this issue, but if you're planning to launch or upgrade a web site, give some thought to making your site accessible to disabled users, both as a risk management step and a public relations tool.**

Faulty Drug Tests: Who's Liable for Employee Loss?

Drug tests are routine in many workplaces, but the tests themselves are often administered by a third party laboratory or medical firm with whom an employer contracts for such services. Who, then, is liable when a faulty test causes harm to an employee? The Wyoming Supreme Court recently held that a testing company is completely liable for injury to an employee caused by a false positive test. The employee worked for a company that contracted with Afton, Inc. for drug and alcohol

testing services. A representative of Afton conducted a urine test on an employee but allegedly sealed the collection instrument improperly and failed to note the temperature of the urine at the time it was taken. Both procedures are required under standard testing protocol. When the employee's sample showed a positive alcohol content, the employee was fired. He then filed suit against Afton, claiming its negligence in collecting and handling the specimen caused the faulty test result, which led to his termination. The state supreme court found Afton could reasonably foresee that its negligence would harm an employee's chances of current or future employment. As such, the court recognized a duty of care incumbent upon the testing agency. *Duncan v. Afton, Inc.*, 1999 WL 1073434 (WY 1999).

➔ **If you conduct any kind of substance abuse testing in the workplace, be sure your service contracts hold the testing agency responsible for faulty tests and any harm they cause. Refer to Nonprofit Alert® Memo 9706-1, *Substance Abuse Prevention in the Nonprofit Workplace*, for details. See back page to order.**

Foundation Resolves Grant Dispute for \$4-Million

The American Health Foundation, based in Valhalla, NY, will pay \$4-million in settlement of a federal lawsuit that claimed the organization misappropriated money from government grants. The cancer research group allegedly used millions of dollars in grant money to pay for general expenses of the organization, rather than conduct the cancer research for which the money was earmarked. A complaint filed by the U.S. Attorney's Office in Manhattan charged the Foundation with filing false statements and improper spending reports in order to overdraw expense accounts associated with federal research grants from September 1991 to December 1994. The Foundation has already repaid some of the money, but this settlement will end the civil proceedings against the Foundation.

Employees & Volunteers

Joint Pay Doesn't Jive: Charity's Policy in Question

A former female lieutenant in the Salvation Army has filed a discrimination claim with the Equal Employment Opportunity Commission, claiming that the charity's pay policy violates her civil rights. The Salvation Army pays its married officers jointly with one paycheck, often in the husband's name. Since the wife doesn't actually receive wages in her own name, this means upon retirement she may not be eligible for social security benefits that would ordinarily accrue during her employment. In addition to this complication, the female plaintiff in the case claims she has been unable to establish credit, obtain any social security tax records for herself, or prove her work history as a result of the Salvation Army's pay policy. During her four year tenure with the organization, both she and her husband served as lieutenants, were considered ordained ministers in the organization, and earned the same salary, but received only one paycheck in the husband's name.

➔ **Legal experts point out that the Salvation Army is a religious organization and is, therefore, exempt from challenges regarding its wage policies for ministers. However, the discrimination issue regarding married employees is another issue altogether.**

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Tax-Exempt Issues

Donations of Stock Options Get Favorable Treatment

For the first time, the IRS has ruled that stock options and other forms of deferred compensation can be donated to charity at the time of the donor's death without creating any estate or income tax liabilities. The IRS noted that a charity receives the same benefit regardless of whether a donation is made in cash, property, stocks or other assets. But when stock options are left to heirs, they produce taxable income when exercised. IRS LTR 200002011.

 **The ruling applies to any “non-qualified deferred compensation,” which may include deferred stock options, deferred income plans, and/or dividends that were earned but never received.**

The Ticket-to-Work Act, which became law in December 1999, made it possible for ministers to opt back into the Social Security system even after electing earlier not to participate. Previously, ministers who, because of conscientious objection, elected to forego Social Security benefits by stopping their payments of self-employment taxes were not permitted under the tax code to revoke that election, once made. This created certain hardships for many individuals, particularly those who wished to qualify for Medicare benefits.

The new law now allows ministers to revoke a prior opt-out election by filing notice with the IRS by April 15, 2002. Upon opting back into the Social Security system, a minister would begin paying self-employment tax as of January 1, 2000 or January 1, 2001, depending on the date of filing.

 **The last time Congress made a similar opportunity available was in the late 1980s, so this is by no means a continuing option. If a forthcoming retirement or other circumstance makes opting back into the Social Security system an attractive option, act swiftly to take advantage of this opportunity while it's available.**

IRS Confirms Reorganization of Related Nonprofits

The IRS has ruled that the reorganization of two tax-exempt health care organizations won't jeopardize their exempt status or create unrelated business taxable income. The first exempt organization operated as a parent entity, which owned a for-profit clinic management company that oversaw several health care clinics. The reorganization called for the clinics to be transferred from the management company through the nonprofit parent organization to the therapy center (which was also exempt). The therapy center would amend its articles of incorporation to account for the change, but otherwise would continue its exempt activities unaffected. The IRS noted that the center's purpose would not change. In addition, the transfer of assets would contribute to the overall purpose of the three exempt organizations in promoting health care and related causes. IRS LTR 200004041.

NPA Highlight of the Month

FMLA Reaches Small “Integrated” Employers

Most small nonprofit organizations don't worry about the Family & Medical Leave Act (FMLA) since it only applies to employers with 50 or more employees. However, the Department of Labor now follows an “integrated employer” test that considers whether related entities are linked so closely as to constitute a single employer. Even if each related entity were to employ fewer than 50, the Department of Labor will apply the FMLA if the total number of employees working at all the related entities equals 50 or more. A recent Virginia case demonstrated this integrated employer test: McGillicuddy Associates, Inc. (MAI) owned and operated a service station, and was a 50 percent stockholder in seven other companies that provided automotive services. The president of MAI was also president of the other seven companies, but retail managers ran the day-to-day operations at each company. After an employee of MAI took leave for a chronic health condition, he was offered a different job upon his return to work, but he refused the offer and filed suit claiming an FMLA violation. The company defended by arguing the FMLA didn't apply since fewer than 50 employees worked at the company. The Fourth Circuit considered four primary factors in determining that MAI and its affiliates were not an integrated employer subject to the FMLA: 1) common management; 2) interrelation between operations; 3) centralized control of labor; and 4) common ownership or financial control. The only common management shared by all related companies was their president who didn't engage in day-to-day operations. Their operations were interrelated but only incidentally, since each company had a separate location, filed separate tax returns, held separate shareholder and director meetings, maintained separate bank accounts, and purchased and/or leased items separately. There was no centralized control of labor since each retail manager made his own hiring/firing decisions. And finally, the common ownership that existed between the companies wasn't enough to show they were a single integrated employer, the ~~court ruled~~ *Hukill v. Auto Care, Inc.*, 1999 WL 739407 (4th Cir., 9/22/99).

 **If your organization is affiliated with several small, related entities, consider performing an integrated employer analysis to determine whether you could be subject to FMLA. For an overview, read Nonprofit Alert® Memo 9407-1, *All in the Family—Living With the FMLA*. See back page to order.**

