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Nonprofit *Alert*®

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

Inside This Issue:

Panel on the Nonprofit Sector Issues Final Report

Senate Concludes Investigation of the Nature Conservancy

IRS Provides Clarification on New Used Car Donation Restrictions

Supreme Court Upholds RLUIPA's Protections for Prisoners' Religious Liberties

$20 Million in DOL Funding Available for Faith-Based and Community Organizations

"Earth Protectors" Failed to Protect Its Name

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Panel on the Nonprofit Sector Issues Final Report

In its "final" report issued last month, the Panel on the Nonprofit Sector urged Congress to require increased reporting, transparency, and electronic filing by tax exempt organizations.

The Panel, convened at the behest of the Senate Finance Committee last fall to develop recommendations for new legislation governing nonprofits, issued an interim report this spring before issuing its final report in June. The final report's recommendations are very similar to those in the Panel's interim report and related work group recommendations. One significant difference is that the final report recommends legislation requiring charities with over $1 million in annual revenues to attach audited financial statements to their Forms 990, while requiring charities with $250,000 to $1 million in annual revenues to obtain a review of their financial statements by an independent accountant. The interim report and work group recommendations proposed higher thresholds: $2 million in annual revenues as an audit trigger and $500,000 in annual revenues as a financial review trigger.

> **the Panel on the Nonprofit Sector urged Congress to require increased reporting, transparency, and electronic filing by tax exempt organizations.**

Other recommendations in the final report include:

- Requiring mandatory electronic filing of the IRS Forms 990, 1023, 8282, and 8283;
- Requiring all tax exempt organizations that are not currently required to file the Form 990 information return because their annual revenues are under $25,000, to file an annual notice with the IRS reporting basic contact and financial information. The IRS could suspend the tax exemption of organizations that fail to file such notices for three consecutive years;
- Requiring greater disclosure on Forms 990, including information regarding compensation, conservation easements, donor advised funds, supporting organizations, and independent board members. The IRS could suspend the tax exemption of organizations that fail to file complete or accurate Forms 990 and pay related financial penalties for two consecutive years;
- Requiring a minimum of three board members for each tax exempt organization;
- Requiring that at least one-third of the members of an exempt organization's board be "independent" (*e.g.,* not paid by the nonprofit or related to anyone paid by the nonprofit);
  Defining and regulating donor advised funds ("DAFs") more closely, requiring a minimum annual payout of 5% of a DAF's assets, and various certifications and agreements from and between a charity and its DAF donors and beneficiaries establishing the charity's discretion and control over its DAFs;
- Tightening the restrictions on "type 3" 509(a)(3) supporting organizations that are not controlled by their supported organizations, requiring annual reporting to the supported organizations and minimum annual payouts of 5% of supporting organizations' assets, and restricting transactions

(continued on page 2)

Final Report.......continued from page 1

between supporting organizations and their donors. Requiring qualified appraisals for charitable contributions of real estate over $100,000 to be prepared by state certified real estate appraisers in accordance with defined standards;

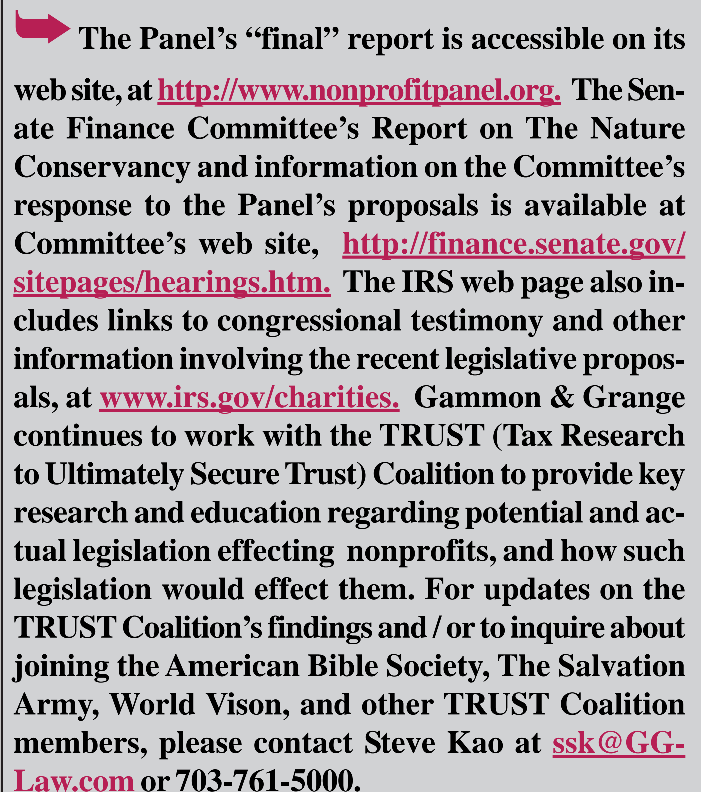
- Prohibiting loans from tax exempt organizations to their board members;
- Imposing Intermediate Sanctions excise taxes on nonprofit organization managers who "should have known" that a transaction they approved would result in an excess benefit to an insider (current law allows such taxes to be imposed only if such managers knowingly or willingly approve excess benefits);
- Increasing the amount of resources allocated to the IRS and states for tax enforcement and oversight of charities, and removing statutory barriers to communication between states and the IRS regarding possible wrongdoing by charities; and
- Requiring the IRS to establish a list of the amounts that taxpayers can claim for charitable contributions of specific items of clothing and household goods.

The final report recommends that several recent legislative proposals affecting charities *not* be adopted, including a 5-year review of each charity's tax exemption, an arbitrary ceiling on tax deductions for contributions of clothing and household goods, and more detailed reporting to the IRS regarding nonprofits' program evaluations and performance measures.

The Panel's report was well received by Sen. Grassley (R-Iowa), Chairman of the Senate Finance Committee. At a news conference, Sen. Grassley stated, "This report today will be of great use as the Finance Committee . . . now begins drafting legislation." He added, "My time line is to have legislation this summer for Finance Committee members to be able to review and then to have the committee mark up legislation soon after that." Thus, the Panel's proposals could be introduced as legislation as early as after this month, before the Senate's summer recess begins.

In early June, the Finance Committee offered additional proposals for increased regulation of nonprofits by Congress and the IRS. As part of its Report on the Nature Conservancy (see below), the Committee made the following proposals, which would affect all nonprofits:

- The IRS should consider modifying Form 990 to require more details on charity's joint ventures with for-profit organizations;
- The IRS should consider imposing greater reporting and review requirements on nonprofits in connection with acceptance of non-cash property and signing Forms 8282 and 8283;
- The IRS and Congress should consider requiring nonprofits with over $10 million in annual revenues to file certifications from independent auditors or legal counsel that the nonprofits' Forms 990 accurately reflect any unrelated business income that they generated;
- The IRS should consider requiring nonprofits to submit, with their Forms 990, appraisals and / or professional opinions demonstrating that their transactions with board members and affiliates are fair and reasonable to the nonprofits; and
- The IRS should consider requiring nonprofits to post agreements with their board members and affiliates on their web sites and to describe such agreements in their Forms 990.



The Panel's "final" report is accessible on its web site, at http://www.nonprofitpanel.org. The Senate Finance Committee's Report on The Nature Conservancy and information on the Committee's response to the Panel's proposals is available at Committee's web site, http://finance.senate.gov/sitepages/hearings.htm. The IRS web page also includes links to congressional testimony and other information involving the recent legislative proposals, at www.irs.gov/charities. Gammon & Grange continues to work with the TRUST (Tax Research to Ultimately Secure Trust) Coalition to provide key research and education regarding potential and actual legislation effecting nonprofits, and how such legislation would effect them. For updates on the TRUST Coalition's findings and / or to inquire about joining the American Bible Society, The Salvation Army, World Vison, and other TRUST Coalition members, please contact Steve Kao at ssk@GG-Law.com or 703-761-5000.

Senate Concludes Investigation of the Nature Conservancy, Targets Conservation Easements

After a two-year investigation, the Senate Finance Committee has concluded that The Nature Conservancy ("TNC") failed to adequately monitor conservation easements, and enabled insiders to take excessive tax deductions for contributions of easements and other property to TNC. But the Committee also found that TNC has recently implemented reforms and standards that minimize the risk of such private benefit to donors.

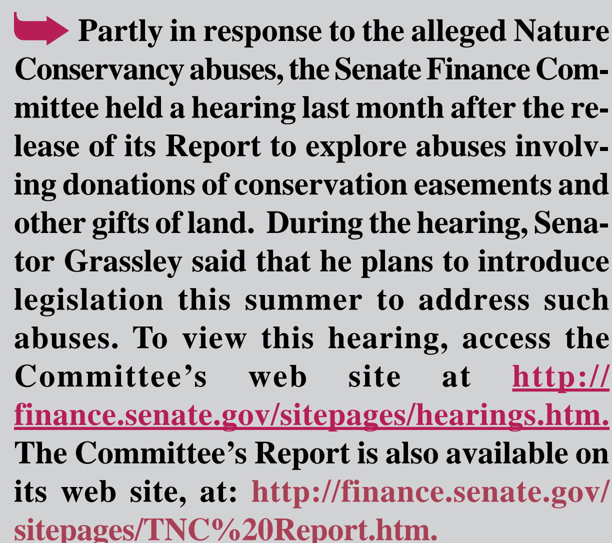
In the spring of 2003, the Washington Post published a series of articles about TNC, the nation's largest land conservation organization, chronicling various insider transactions involving conservation easements given by the insiders to TNC. The landowners would pledge to comply with development restrictions on their property, and in exchange were able to take charitable contribution deductions for the value of the easements, while retaining ownership of the property. The Post found that many donors who received conservation easements exaggerated the value of their easements in claiming unlawfully large tax deductions. In response to the Post's articles, the Senate Finance Committee initiated its investigation, and TNC began to review and reform its policies regarding conflicts of interest and internal accountability (see May 2004 Nonprofit ***Alert***®).

In its Report, the Finance Committee confirmed that TNC donors took excessive deductions for conservation easements, and that some donors used the money from their easements to develop golf courses, in violation of development restrictions. The Committee focused on TNC's Conservation Buyer Program ("CBP"), in which TNC would purchase land, place easements on the land, then sell it to buyers (primarily TNC trustees) at a loss. The buyers would then make cash "gifts" to TNC equal to the value of TNC's loss on the sale, and take tax deductions for such payments. The Committee's report questioned the donative intent behind such "gifts," which it found were generally required by TNC as a condition of the property sales. The Committee also suggested that some of the appraisals of easement valuations were inflated, further increasing the donors' excessive tax deductions. It concluded that federal regulations governing real estate and easement appraisal procedures were scant and ineffective.

In its Report, the Committee recommends that the IRS:

- withdraw the tax-exempt status of nonprofits that fail to monitor and maintain the integrity of their conservation easements, and impose excise taxes on the leadership of such nonprofits;
- require such nonprofits to hire skilled internal officers or independent counsel to advise the nonprofits charities on how to comply with the laws and regulations governing charitable contributions, and to avoid facilitating donors' tax evasion; and
- require that organizations with programs similar to TNC's CBP make land available for sale to the general public–-not just to insiders—to obtain fair market value for such sales and to avoid generating excess benefits to insiders. TNC has instituted such a policy.

The Committee did not recommend, in its Report, that Congress or the IRS impose any penalties against TNC for facilitating its insiders' excess benefits from sales / gifts of easements and other property to TNC. However, the IRS is continuing its audit of TNC.


Partly in response to the alleged Nature Conservancy abuses, the Senate Finance Committee held a hearing last month after the release of its Report to explore abuses involving donations of conservation easements and other gifts of land. During the hearing, Senator Grassley said that he plans to introduce legislation this summer to address such abuses. To view this hearing, access the Committee's web site at http://finance.senate.gov/sitepages/hearings.htm. The Committee's Report is also available on its web site, at: http://finance.senate.gov/sitepages/TNC%20Report.htm.

IRS Provides Clarification on New Used Car Donation Restrictions

The IRS has issued a Notice clarifying when donors may take full fair market value ("FMV") deductions for gifts of vehicles to nonprofits, and what information charities must include in their acknowledgments of such donations.

IRS Notice 2005-44 (the "Notice") explains and expands on the provisions of the American Jobs Creation Act of 2004 (the "Act"). As reported in the December 2004 / January 2005 Nonprofit ***Alert***®, the Act requires that, for a donor to take a charitable contribution deduction for a donated vehicle worth over $500, the donor must receive from the donee charity and submit to the IRS with the donor's tax return a "contemporaneous written acknowledgment" of the gift.

This acknowledgment must include (1) the name and taxpayer ID of the donor, (2) the vehicle identification number, and additional information depending on what the charity does with the vehicle. If the charity sells the vehicle "without any significant intervening use or material improvement," the acknowledgment must also include (1) a certification that the vehicle was sold in an arm's length transaction, (2) the gross proceeds from the sale, and (3) a statement that the deductible amount may not exceed the amount of such gross proceeds. Then, the donor can only deduct the amount for which the charity sold the vehicle.

If, however, the charity does not sell the vehicle, or sells it only after significant use or material improvement, the Act requires the charity's acknowledgment to also include: (1) a certification of the charity's intended use or material improvement of the vehicle, and the intended duration of such use; and (2) a certification that the vehicle will not be transferred in exchange for money, services, or other property before completion of such use and improvement.

For the acknowledgment to be "contemporaneous," the Act requires that it be provided to the donor by the donee charity within 30 days of the donor's contribution or, if the charity sells the vehicle without any significant use or material improvement, within 30 days of its sale of the vehicle.

The Notice clarifies the meanings of "significant intervening use" and "material improvement." "Significant intervening use" means that the donee charity uses the vehicle to substantially further its regularly conducted activities, and such use is significant rather than incidental. For instance, using a car to deliver meals every day for a year would be significant intervening use. "Material improvement" includes major repairs or improvements that improve the condition of the qualified vehicle in a manner that significantly increases its value. Cleaning, waxing, and minor repairs would *not* be considered material improvements by the IRS. If a charity makes either "significant intervening use" of a donated vehicle or a "material improvement" to the donated vehicle, the donor may take a deduction for up to the vehicle's FMV at the time of donation, rather than the charity's resale price, if the donor receives a contemporaneous written acknowledgment.

The Notice also provides another exception, not included in the Act, to the rule that a donor's deduction is limited to the gross proceeds of the donee charity's sale of the vehicle. The Notice states that if a charity sells a vehicle at a price significantly below FMV to a needy individual or gratuitously transfers the vehicle to a needy individual, and the sale or transfer is in direct furtherance of the donee organization's charitable purposes (*e.g.,* providing transportation to low-income persons), then the donor may claim a deduction of the FMV of the vehicle. In this case, the contemporaneous acknowledgment must certify that the charity will so sell or transfer the vehicle and that such sale or transfer will directly further its charitable purpose.

The Notice also explains how donors may determine the FMV of their vehicles. If a donor claims a deduction based on the FMV of the donated vehicle, he or she must be able to substantiate that value. Consulting an established used vehicle pricing guide may be a reasonable method of determining the fair market value. However, the pricing guide must list prices for a vehicle of the same make, model, and year, sold in the same area at the same condition, with the same or substantially similar options or accessories, and with the same or substantially similar warranties or guarantees. If a donor plans to claim a deduction of more than $5,000 for a vehicle, and if the deduction is not limited to the amount for which the charity sold the vehicle, the donor must submit a qualified appraisal of the vehicle to the IRS.

The Act also requires charities to submit their contemporaneous written acknowledgments of donations for vehicles not only to donors, but also to the IRS. The Notice states that the IRS is developing a Form 1098-C for this purpose. A charity may provide the contemporaneous acknowledgment to the donor in any reasonable manner, including email or by submitting a copy of Form 1098-C to the donor.

Vehicle Donation Rules...[continued from page 4]

The Notice may be accessed online at http://www.irs.gov/irb/2005-25_IRB/ar09.html. The IRS has requested comments on the Notice and suggestions for further guidance, which may be submitted to the IRS at Notice.Comments@irscounsel.treas.gov by September 1, 2005. Gammon & Grange may be preparing comments on behalf of several charities that have substantial used car donations programs. If your organization may be interested in participating or would like more information, contact Steve Kao at ssk@GG-Law.com or (703) 761-5000.

Supreme Court Upholds RLUIPA's Protections for Prisoners' Religious Liberties

The United State Supreme Court has upheld the institutionalized-persons provision of the Religious Land Use and Institutionalized Persons Act (RLUIPA), thereby preserving RLUIPA's protections for the religious liberties of prisoners.

RLUIPA protects religious liberties in two distinct contexts: (1) protection of churches and other religious organizations from discriminatory zoning and land use laws and their application, and (2) protection of institutionalized persons (*e.g.,* prisoners) from discrimination on the basis of religion. In both cases, RLUIPA prohibits government from substantially burdening the exercise of religion without a compelling state interest. In addition, the government also must use the least restrictive means of furthering that compelling governmental interest.

In the case before the Supreme Court, three Ohio prisoners sued prison officials in three separate actions that were eventually consolidated. Each prisoner alleged that he was denied the right to practice his religion, in violation of RLUIPA, because of unwarranted concerns over security. The Sixth Circuit ruled against the prisoners on the ground that RLUIPA's institutionalized persons provision violated the U.S. Constitution's Establishment Clause, and was therefore unconstitutional.

The Supreme Court disagreed and overturned the Sixth Circuit's decision. Writing for the majority, Justice Ginsburg explained that "the government may … accommodate religious practices … without violating the Establishment Clause" and that "RLUIPA does not differentiate among bona fide faiths" and "confers no privileged status on any particular religious sect, and singles out no bona fide faith for disadvantageous treatment." In response to state and local governments that such accommodations will create unacceptable security risks, the Court stated, "[w]e do not read RLUIPA to elevate accommodation of religious observances over an institution's need to maintain order and safety. Our decisions indicate that an accommodation must be measured so that it does not override other significant interests." See http://laws.findlaw.com/us/000/03-9877.html for the Court's opinion, Cutter v. Wilkinson, No. 03-9877 (S. Ct. May 31, 2005).

The Court did not address RLUIPA's protection of the religious liberty interests of churches in using their properties. The legality of these land use protections has been questioned on the ground that federal restrictions on land use within states may unconstitutionally intrude into states' exclusive jurisdiction, in violation of the 10th Amendment of the U.S. Constitution, but to date no Circuit Court has ruled RLUIPA unconstitutional on these grounds.

$20 Million in DOL Funding Available for Faith-Based and Community Organizations

The Department of Labor (DOL) will be awarding grants totaling approximately $20 million to faith-based and community organizations (FBCOs) for the purpose of helping ex-prisoners find employment. Interested FBCOs may apply for such grants through **July 13, 2005.**

The grants are designed to further the President's *Prisoner Reentry Initiative,* which seeks to strengthen urban communities through employment-centered programs that incorporate mentoring, job training, and other transitional services. The Initiative is designed to reduce recidivism by helping inmates find work when they return to their communities. Several federal agencies are involved in this Initiative. They hope to serve 6,250 released prisoners during the first year of this initiative with projects operating in 30 communities across the country. The Department of Justice also plans to make grants related to the Initiative.

An FBCO is eligible to apply for the DOL grants if it is a faith-based or community-based organization and is located or has a staff presence within the urban community that is the focus of its grant application. Applicants will identify as part of their applications the need in the community that they plan to serve; their proposed FBCO sub-grantees, if any; their plan for serving released prisoners; and their partnerships with the criminal justice system, local housing authority, and mental health and substance abuse treatment providers. Each grantee awarded a DOL grant may choose to directly provide services to released prisoners, provide sub-grants to other FBCOs to provide these services, or use a mixed approach of providing some direct services while using other

(continued on page 6)

DOL Funding...*(continued from page 5)*

FBCO sub-grantees to provide other services. Lead grantees will be responsible for providing technical assistance and oversight to their sub-grantees.

The closing date for receipt of applications by the DOL is July 13, 2005. Applications must be received no later than 5 p.m. (EST). For more information, access the DOL web site at http://www.doleta.gov/sga/sga.cfm.

"Earth Protectors" Failed to Protect Its Name

A United States District Court has ruled that the Walt Disney Company did not infringe the trademark of Earth Protectors, Inc., an environmental activist group, when Disney uses the name, "Earth Protectors" in its television movie, "Up, Up, and Away."

The Disney movie was about a family of superheroes who uncover and thwart the plot of the diabolical president of a fictitious company called "Earth Protectors," which developed software used to control and manipulate the minds of children.

Although the real Earth Protectors, Inc. ("EPI") had used its trademark for about 14 years prior to the release of the Disney movie, and had federally registered its trademark, the court ruled in favor of Disney on the ground that there was no likelihood of confusion between Disney's use of the name and the environmental organization's use of the mark. One of the determining factors for the court was that EPI had federally registered its mark only for printed publications and clothing, not for any goods or services related to movies. Although EPI had produced local television programs for several years, it did not register its trademark for such programs. The court held that even if EPI had registered its trademark for television programs, the mark was descriptive, and therefore weak and entitled to limited protection. Ultimately, the court found that the marks of EPI and Disney were not used in "commercial proximity," and therefore no likelihood of confusion existed between them.

Davis v. The Walt Disney Company, 2005 WL 578202 (D.Ct. Minn. 2005).

Nonprofit organizations often desire names that describe their purposes or programs. Unfortunately, descriptive names are the weakest form of trademarks, and are entitled to very limited protection (until they are used extensively enough to have acquired "distinctiveness"). Marks that are inherently distinctive (*e.g.,* EXXON, HÄGGEN-DAZS) are stronger in trademark significance and are therefore easier to register and to protect from infringement by others.

Federal registration of trademarks is an important means of protecting them from infringement. However, having a registration that is limited in scope does not ensure adequate protection; it is important that marks be registered for a comprehensive scope of goods and services. Nonprofits should consider registering their marks not only for their core services, but for all related products and services that they provide or may provide. For more information on adopting and protecting your nonprofit's trademark(s), contact Ken Liu at (703) 761-5000 or kel@GG-Law.com, and /or order Nonprofit *Alert*® Memo, *Trademark Law for Nonprofits*. (See below for information on how to order.)

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