



Nonprofit *Alert*®

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

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Senate-Commissioned Panel Releases

Recommendations on Nonprofit Legislation

A panel of nonprofit experts convened by the Independent Sector (“IS”) has released 21 preliminary recommendations for new legislation to improve nonprofits’ financial management, governance, and self-regulation, and is soliciting public comment on these recommendations until February 18.

As reported in the August/September and October/November 2004 editions of the **Nonprofit Alert®**, the Senate Finance Committee has held hearings to consider legislation that would significantly increase regulation of tax exempt organizations. Last fall, the Committee asked IS to convene its Panel on the Nonprofit Sector (“Panel”), a panel of experts who will recommend legislative action to curb abuses at nonprofits. In turn, the Panel created five Work Groups and an Expert Advisory Group (“EAG”) to discuss the Committee’s proposed legislation and make their own recommendations. Although the Panel is not scheduled to make its report to the Committee until early March, it has released 21 of its Work Groups’ recommendations and the responses of the EAG to each of these recommendations, which the Panel will deliberate over before making its initial report. A final report is due later this spring. Ten of the proposed regulations that would have a substantial impact on charities are summarized as follows:

The Senate Finance Committee has held hearings to consider legislation that would significantly increase regulation of tax exempt organizations.

1. Certification of IRS Information Returns: A nonprofit’s Forms 990 would have to be signed, under penalties of perjury, by its CEO, CFO, or its highest ranking officer or trustee.
2. Mandatory Electronic Filing of IRS Forms. Charities would need to file their annual information returns (Form 990 or Form 990-PF) electronically. (Note: the Treasury Department recently adopted new regulations requiring charities with total assets of \$100 million or more to file their Forms 990 electronically, beginning in 2006.) The EAG also recommends that the IRS consider mandating electronic filing of the Form 1023, *Application for Recognition of Exemption*.
3. Annual Notification Requirement. Charities that are not required to file Forms 990 and whose gross annual receipts exceed \$5,000 would be required to file a one-page information form with the IRS and/or the appropriate state regulatory official. The form would include the charity’s name, contact information, principal officer’s name and address, total revenues and expenditures for the preceding year, a statement of its mission, and a summary of its activities during the preceding year. The EAG recommended that an IS Work Group consider whether churches and their integrated auxiliaries should be subject to or exempt from this requirement.

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4. Financial Audits and Reviews. A new organization would be established to develop tax exempt accounting standards and audit rules, similar to the Public Company Accounting Oversight Board called for in the Sarbanes-Oxley Act of 2002. An IS Work Group also recommended that every public charity with gross revenues of \$2 million or more be required to prepare annual financial statements in accordance with generally accepted accounting principles, and have these statements audited by an independent CPA.

5. Public Disclosure of Financial Statements. Charities that are required by law to have audited financial statements would be required to file these statements with their Forms 990 and make those statements available for public inspection.

6. Donor Advised Fund Regulation. Charities would be required to pay out annually a minimum of 5% of their aggregate assets held in donor-advised funds, and to provide certifications from donor-advisors and grantees that proposed grants will not result in any benefit to the donor-advisors. They would be prohibited from making grants from donor-advised funds to non-operating private foundations.

7. Federal-State Cooperation in Enforcement of Federal Law. States would be encouraged to incorporate and enforce federal tax law against tax exempt organizations. The IRS and states' attorneys general would be able to share information with one another regarding alleged violations of federal law by nonprofit organizations. The EAG believes this would facilitate coordination of state and federal efforts to enforce federal law, and ensure that the same standards are upheld across states.

8. Public Disclosure of IRS Determinations. The IRS would be authorized to disclose to the public closing agreements

with charities and other audit results, so long as it deletes identifying information of charities when audits of such charities are initiated pursuant to information volunteered by those charities.

9. Policies for Whistleblower Encouragement and Protection. Charities would be required to establish policies and procedures that encourage individuals to come forward with credible information on illegal or unethical practices at those charities, and that protect such individuals from retaliation.

10. Mandatory Conflicts of Interest Policy. Charities would be required to establish conflicts of interest policies governing transactions between the charities and their directors and officers, to ensure that such transactions comply with federal law.

In addition to this recommended legislation, the EAG also recommends, as a "best practice," that each public charity and private foundation that secures an independent audit have an audit committee of its board of directors made up of non-staff, independent directors.

➔ These recommendations may be reviewed at www.NonprofitPanel.org, and the public may comment on them through February 18 at www.NonprofitPanel.org/workgroupprecs.public. The Panel will consider these public comments, along with the Work Group and EAG recommendations, before submitting its initial report to the Senate Finance Committee in March.

To Order Memos: Memos referenced in the Nonprofit Alert can be purchased for \$20 each (\$10 for clients) from Gammon & Grange, P.C. Five or more copies of the same memo are bulk priced at \$5 each. Visit the [Nonprofit Alert Memo Page](#) for details.

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Liability & Risk Management

IRS Investigates Possible Political Campaign Violations by NAACP

The IRS is investigating whether the National Association for the Advancement of Colored People (“NAACP”) violated the prohibition on 501 (c)(3) organizations’ involvement in political campaign activity during the 2004 presidential campaign.

In a letter to the NAACP, the IRS cited a speech by NAACP’s chairman, Julian Bond, which criticized the administration policies of George W. Bush on education, the economy, and the war in Iraq. In the same speech, Bond encouraged NAACP chapters to redouble their efforts to get voters to the polls. “If whites and blacks vote in the same percentages as they did in 2000, Bush will be re-defeated by three million votes,” Bond said.

The IRS asked the NAACP to provide details about its operations, including the names and identities of board members who authorized Mr. Bond’s speech, and minutes of Board meetings in which a decision was made to distribute copies of the speech. The NAACP claimed that Mr. Bond was engaging in free speech by articulating his disagreement with the President’s policies, and was not advocating his defeat in the election.

Some lawmakers also objected to the IRS investigation. Sen. Max Baucus, ranking minority member on the Senate Finance Committee, sent a letter to IRS Commissioner Mark Everson

that compared the IRS’s action to the Nixon administration’s use of the IRS to audit the President’s enemies. Sen. Baucus asked Commissioner Everson for the names of IRS officials who signed off on the NAACP inquiry; what steps led to the decision to investigate the NAACP; whether the White House, any political appointees in the federal government, or members of Congress requested the inquiry; and whether the IRS was auditing any organizations critical of John Kerry. Everson denied that the IRS audited the NAACP or any other charity at the behest of the White House or any political appointee. Everson added that the IRS had received two letters from Congressmen asking for investigations of charities (which he did not identify) involving possible campaign intervention.

The NAACP is not alone. The IRS convened a special committee that has reviewed more than 100 churches and other charities for which it had received public complaints about alleged political campaign activities, and has audited or is still auditing 60 of these charities. The IRS has not identified any of these charities.

The former president of NAACP, Kweisi Mfume, recently resigned from his office. Mfume stated that his resignation was unrelated to the investigation.

➔ Although Section 501(c)(3) exempt organizations are permitted to engage in a *non-substantial* amount of lobbying, and are not limited in their capacity to educate the public about political issues, per se, they are absolutely prohibited from engaging in political campaign activities. This prohibition applies to both direct and *indirect* political campaign activity. Thus, if a nonprofit engages in lobbying or “issue advocacy” that involves criticism or promotion of a candidate for public office, as in Mr. Bond’s speech, the IRS may construe such criticism or promotion as *indirect* political campaign activity. For an overview of the legal restrictions on nonprofits’ participation in political activity, see *Nonprofit Alert® Memo, Nonprofit Lobbying and Political Activity—Know Your Limits* and Gammon & Grange’s article in the Baptist Press News, at www.bpnews.net/printerfriendly.asp?ID=18752. Please contact Steve King at (703) 761-5000 or www.gg-law.com for any specific questions regarding IRS political activity rules.

Employment and Intellectual Property

DOL Issues New Rules on Foreign Workers

The U.S. Department of Labor (“DOL”) has published final rules governing the labor certification application system—the process a U.S. employer must follow to sponsor a foreign national employee for “green card” status or permanent residence. These new rules will become effective on March 28, 2005.

The new rules—which will be implemented as part of the Program Electronic Review Management (“PERM”) program—are similar or identical in many respects to the current rules. They will still require that an employer applying to sponsor a foreign national must prove to the DOL that the employer is unable to find a willing, able, and qualified U.S. worker to fill the job offered to the foreign national, after making bona fide efforts to recruit for the position. This recruitment must be conducted at least 30 days, but no more than 180 days, before filing the application. The employer must also prove that employing the foreign national will not adversely affect the wages and working conditions of U.S. workers similarly employed.

There are several major differences between the current labor certification process and the PERM program rules. First, under the PERM program all of the employer’s advertisements for the job must contain the employer’s name. Under the current system, the employer may advertise anonymously. The PERM program also requires the employer to place two advertisements for the job in the Sunday edition of a local newspaper, and to place a job order with the appropriate state work force agency.

Second, the PERM program expands the definition of a “qualified” U.S. worker who must be given preference for a job over a foreign national. Under the current system, a

U.S. applicant is not qualified for a job if he or she does not meet the education, experience, and special requirements listed on the labor certification application. Under the PERM program, a U.S. applicant will be considered qualified if he or she can acquire the skills necessary for the job during a “reasonable period of on-the-job training.” The rules do not define “reasonable period.”

The new PERM rules will also require employers to notify and consider for the job all former employees who held the same or a similar position, and who the employer laid off in the 6-month period prior to filing the application.

Not all foreign nationals seeking permanent U.S. employment will be required to file a labor certification application under the PERM program. For example, multinational executives, managers, and employees who have “extraordinary ability” in their field will be exempt from the labor certification process.

An employer’s filing of a labor certification application is the first of three steps in obtaining employment-based U.S. permanent residence for a foreign national employee. The second step is filing an immigrant visa petition for the employee with the Citizenship and Immigration Services (“CIS”). The third step is the foreign national employee filing an adjustment of status application with the CIS to obtain a green card.

The DOL will permit employers and foreign nationals with pending labor certification applications to convert to a PERM application beginning on March 28, 2005, when the new PERM rules take effect. The DOL has promised that PERM labor certification applications will be processed in 45-60 days, as opposed to the current 3-4 years. These new rules are published in the Federal Register at Vol. 69, No. 247, 20 C.F.R. §§655-656.



Supreme Court Rules on Fair Use of Trademarks.

The U.S. Supreme Court ruled in December that the generic use of another's federally registered trademark is "fair use" so long as it is used in a generic manner.

Despite the fact that Lasting Impression I, Inc. owned a federal trademark registration for MICRO COLORS® to identify its permanent cosmetic makeup, and despite the fact the federal registration had become incontestable under U.S. trademark law, the Supreme Court permitted KP Permanent Make-Up, Inc. to use the term "microcolors" to describe its permanent makeup. The Court upheld the lower court's position that because KP was using "microcolors" to describe its product, but not as a trademark to identify its product, then its use of "microcolors" was fair, and not infringing. A different result might have occurred if there had been evidence that KP had identified its product with the term "microcolors" as a trademark. *KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc.* (03-409) 543 U.S. __ (December 8, 2004).

➔ **This case emphasizes the importance of choosing trademarks that are distinctive and not likely to be used generically or descriptively by someone else. A name that is distinctive reduces the chance of confusion with other names or terms. The most distinctive, and therefore strongest, marks are those that are completely made up, such as KODAK® and EXXON®. The next strongest marks are those that are real words, but unrelated to the goods or services they identify, such as APPLE® computers. The weakest marks are those that merely describe some aspect of the goods or services; for instance, NONPROFIT JOURNAL as the name of a magazine for nonprofit organizations. Many nonprofit organization like to use descriptive terms to describe their goods and services, but fail to recognize that the more descriptive the mark, the more difficult it is to protect the mark.**

Before adopting a new trademark, always conduct a trademark search to determine whether there are confusingly similar marks already being used. For all of your organization's more important marks, have an experienced trademark attorney conduct a comprehensive search and provide an opinion on the protectability of the mark before adopting it. For more information on adopting and protecting trademarks, see *Nonprofit Alert® Memo, Trademark Law For Nonprofits* and/or contact Ken Liu at (703) 761-5000 or kel@gg-law.com.

Nonprofit and Tax Exempt Organization Issues

New Law Encourages Tsunami Relief Efforts

The IRS has alerted taxpayers who itemize deductions that they may deduct, on their 2004 tax returns, charitable donations they made during January 2005 for relief of the victims of the Indian Ocean Tsunami. The IRS will deem any such donations as having been made on December 31, 2004. Taxpayers will not need to fill out any additional forms to claim such deductions.

This retroactive deductibility will only cover cash contributions made specifically for the relief of victims in areas affected by the Dec. 26, 2004 tsunami in the Indian Ocean. The new law gives taxpayers the option of deducting the contributions on either their 2004 or 2005 returns.

In its advisory, the IRS reminds donors that contributions to foreign organizations generally are not deductible, and encourages taxpayers to ensure that their contributions go to qualified charities. Taxpayers can check the IRS web site, www.IRS.gov, to confirm that a particular charity is recognized by the IRS as tax exempt.

➔ The IRS advisory is accessible at <http://www.irs.gov/newsroom/article/0,,id=133843,00.html>. Also, IRS Publication 526, *Charitable Contributions*, provides information on making contributions to charities. IRS Publication 3833, *Disaster Relief: Providing Assistance through Charitable Organizations*, explains how the public can use charitable organizations to help victims of disasters. Both publications are available on the IRS's web site.

IRS Offers Workshops for Tax Exempt Organizations

The IRS recently announced that it will offer workshops on exempt organization tax law beginning in April 2005. These eight-hour workshops will be designed primarily to help small and mid-sized nonprofits. Among other issues, they will cover unrelated business income, Form 990 preparation, employment issues, recordkeeping and disclosure, and activities that can jeopardize a nonprofit's tax exempt status. The IRS will offer these workshops in Houston, New York, San Francisco, Cleveland, Charlotte, and Washington, D.C. For more information, see www.irs.gov/charities/article/0,,id=96083,00.html#small_mid.

Strategic Planning for Nonprofits: What and Why?

Everyone knows they need a good strategy to live successful personal and professional lives. However, few people can say what a good strategy looks like and how to go about formulating one. In the nonprofit world, more and more nonprofits are investing time and resources to articulate their strategic direction.

To clarify what organizational strategic planning is all about, let's take an example from the world of sports. A hypothetical coach is preparing his team to run a relay from point A to point B. The team can pick any route to get from A to B, but is allowed to use only five runners. What must the coach do to come up with a winning strategy for this race? Upon reflection, the coach realizes that his team performs best in long, flat runs, but is less competitive on hilly terrain. Based on this insight, his first decision is to choose the route with the gentlest inclines, even though it is somewhat longer than the others. Even on this route, though, there is one long, steep hill where his runners could lose time and momentum. So, he decides that a baton exchange will occur midway up the hill.

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Then he turns his attention to the sequence of runners. He knows that his strongest runner can easily run long distances on flat terrain without compromising his performance. He decides to optimize the team's time by having the strongest runner run about 30 percent of the race over completely flat terrain, with the other four runners sharing the inclines. He also places his best two hill runners to split the one difficult hill. Finally, he thinks about what training will best prepare each runner for their respective legs of the race.

This example illustrates several elements of organizational strategic planning. In the simplest terms, developing a strategy is about determining the best way to achieve your nonprofit's goal(s). It is not a single action, but an approach or a framework that guides a series of decisions and actions. The first step in developing a strategy is to consider the complete range of paths your nonprofit can take to achieve its goals. Choosing among these paths involves assessing your nonprofit's strengths and weaknesses against the "lay of the land" and the competition. This kind of assessment led our hypothetical coach to select a path that capitalized on his team's ability to run longer, flatter stretches and minimized the impact of their weakness on steep climbs. The coach also used his "assets" (*i.e.*, his runners) strategically, giving each of them a role that would maximize their contributions to the team's performance. Thus, strategy affects resource allocation.

Strategic planning is different from day-to-day management decisions. In our relay example, such decisions would include making sure that all the runners are prepared for the race and their role in it, that they all know the race route, and that no one has a shoe that pinches. Both strategic planning and day-to-day management are necessary for a nonprofit's continued success. Even the most efficient and effective organization needs a strategy to win the race.

This article was contributed by Dr. Purnima Chawla, the Executive Director of the Center for Nonprofit Strategies. The Center provides organizational, marketing and communication counsel for nonprofits. For more information about the Center, visit <http://www.cnpsweb.org> or contact Dr. Chawla at (301) 920-1230.

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8280 Greensboro Drive, 7th Floor, McLean, VA 22102-3807 • (703) 761-5000 Fax: (703) 761-5023 • E-mail: npa@gg-law.com

Editor-in-Chief George R. Grange II Editor Stephen M. Clarke

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