Gammon & Grange, P.C. May/June 2005

Nonprofit Alert®

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

Inside This Issue:

Charity Sues Its Founder to Protect Its "Habitat"

ACLU Challenges Silver Ring Thing

House Passes Estate Tax Repeal

New Nonprofit Mail Ruling Effective June 1st

The Confederacy Lives: Vanderbilt Must Honor Donor's Confederate Condition

IRS Issues Clarification on International Grant Rules

Dept. of Justice Launches National Sex Offender Public Registry Site

IRS Announces Proposed E-Filing Requirements

Nonprofit Alert is published bi-monthly by the Virginia law firm of Gammon & Grange, P.C.

Congressional Scrutiny of Charities Intensifies as Senate Passes Legislation

Momentum seems to be building in Congress for comprehensive legislation to address alleged abuses by the nonprofit sector, as the House has now joined the Senate in holding hearings focused on major exempt organization reform, and the Senate has begun what may be a strategic piecemeal approach to passing legislation to curb such abuses.

Last month, **Senate Finance Committee Chairman Charles Grassley** attached a corporate tax provision to the highway bill (HR3) that the Senate passed on May 17. The provision requires the CEO of each corporation (or another officer, if a corporation doesn't have a CEO) to declare on the corporation's annual tax return that it has in place processes that ensure compliance with all tax law, and that the CEO "was provided reasonable assurance of the accuracy of all material aspects of such return." This provision likely will apply to nonprofits that file Forms 990-T to report unrelated business income tax. The legislation does not state whether "annual tax return" includes the Form 990 information return filed by nearly 500,000 nonprofits annually.

The Senate has begun introducing legislation aimed at curbing abuses by tax exempt organizations.

Sen. Grassley and **Sen. Max Baucus** have also introduced legislation (S993) that would crack down on abuses in certain life insurance and annuity transactions involving individuals and companies that use tax exempt organizations to gain prohibited private benefit; for instance, charities purchasing life insurance policies on their donors, then selling their interest in the policies to private investors. The legislation, if passed, would impose a tax on any person or corporation that acquires an interest in such an insurance contract. The tax would be 100% of the cost of acquiring such an interest.

Congress continues to hold hearings to consider additional legislation and other means of regulating nonprofits. On April 5th, the Senate Finance Committee heard further testimony from **IRS Commissioner Mark Everson**, which included a description of how donor-advised funds and 509(a)(3) supporting organizations have been manipulated for private benefit. (Sens. Grassley and Baucus have since pledged to crack down on such abuses) Mr. Everson also estimated the amount of overstatements in charitable contribution deductions to be $15-$18 million annually. **George Yin, Chief of Staff of the Joint Committee on Taxation**, advocated limiting the tax deduction for non-cash property donations, other than donations of publicly traded stock, to the donor's basis in the property, and capping donations of used clothing and household goods at $500 per year, per donor. A broadcast and transcript of this hearing are available on the Finance Committee's web site at http://finance.senate.gov.

(continued on page 2)

Congressional Scrutiny....[continued from page 1]

The **House Ways and Means Committee** joined the EO regulation party by commencing a series of ambitious overview hearings. At the first, held April 20, seven witnesses described the fundamental principles and problems of modern-day tax exempt law, and offered their recommendations for revamping the law. Tax exempt attorney **Bruce Hopkins** called the current state of tax exempt law "disparate, irregular, unbalanced, and uneven." He offered a dozen recommendations, including more specific regulation of joint ventures between for-profits and nonprofits and of the relationship between nonprofits and their for-profit subsidiaries. Other witnesses advocated changing the basis on which the IRS grants tax exemption. **John Columbo** of the University of Illinois College of Law suggested that tax exemption should be granted only to organizations that are substantially dependent on donations for their operating revenues. **Francis Hill** of the University of Miami School of Law suggested that tax exempt status should be given only to organizations that provide a sufficient public benefit to a defined category of beneficiaries.

During the week of May 9, the **Panel on the Nonprofit Sector** released draft recommendations for its final report in late June, which are generally less stringent and intrusive than the Senate Finance Committee's initial proposals. These recommendations are accessible on the Panel's web site, at http://www.nonprofitpanel.org. They include requiring nonprofits to disclose all compensation (including fringe benefits) provided to their board members, and the services provided in exchange for such compensation, on their Forms 990; a statutory definition of and minimum annual payout requirements for donor-advised funds; a minimum of three directors on nonprofit boards; a minimum of one-third of each nonprofit's board consisting of independent directors; greater disclosure requirements for supporting organizations that are closely affiliated with, but not controlled by, their supported charities; establishment of standards for qualified appraisers and appraisals of non-cash contributions; and increasing penalties for inflating the value of non-cash contributions.

➥**In the face of this growing momentum for sweeping nonprofit legislation, Gammon & Grange is working 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. To date, the TRUST Coalition's founding members include the American Bible Society, Assemblies of God Foundation, Association of Gospel Rescue Missions, Salvation Army, World Vision, and associate members National Religious Broadcasters and Prison Fellowship Ministries. The Coalition's first research project involved an assessment of the abuses cited at the Senate Finance Committee's June 22, 2004 hearing, and found that 92 of the 94 cited abuses (out of a universe of 1.8 million exempt organizations) are addressed in existing law (see March / April 2005 Nonprofit *Alert*®). This study was quoted by Senator Rick Santorum at the April 5th Senate Finance Committee hearing. The Coalition has 5 other research projects in process, including analyzing alleged nonprofit abuses reported in the media and in the most recent congressional hearings, and evaluating the Congressional Research Service study that the Senate Finance Committee has cited as providing foundational support for its reform proposals. For updates on the TRUST Coalition's findings and / or to inquire about joining the Coalition, please contact Steve Kao at ssk@GG-Law.com or 703-761-5000.**

Charity Sues Its Founder to Protect Its "Habitat"

Habitat for Humanity International has sued its founder, Millard Fuller, and his new charity to prevent them from using the new charity's name, "Building Habitat, Inc." The lawsuit was filed last month in federal district court in Georgia. It alleges that Fuller's use of the Habitat name infringes on Habitat for Humanity's trademark, will be confusing to donors, and therefore will interfere with Habitat for Humanity's operations and hurt its reputation. Chris Clarke, Habitat for Humanity's Senior Vice President, explained to the Associated Press, "This is a business issue. It's not about personalities. It's about protecting a brand."

Fuller, who founded Habitat for Humanity in 1976 to build and improve housing for the poor, was fired on January 31, 2005 amidst allegations that he had sexually harassed a female colleague. Fuller's new charity, Building Habitat, Inc., is also organized to build housing for the poor, and to raise money for Habitat for Humanity and its affiliates. The two charities are located in the same town–Americus, Georgia.

➥ **Directors of a nonprofits have a fiduciary duty to reasonably protect the organization's assets, including its copyrights, trademarks, and other intellectual property, against misuse or infringement by third parties. Accordingly, trademarks and other IP that are key to the nonprofit's mission should belong to the nonprofit, not to any individual, even if the individual who created the trademark was the founder, director, or officer of the nonprofit. Any use of a confusingly similar mark for activities similar to those of the nonprofit, by any entity (including a departing employee), would typically constitute unlawful trademark infringement. To protect its trademark rights, a nonprofit should not only take *reactive* measures such as cease and desist letters and litigation, but also *proactive* measures such as trademark registration, affixing trademark symbols to public uses of the nonprofit's trademarks, and IP ownership and protection provisions in employment and severance agreements. Such agreements should prohibit an employee from using the nonprofit's intellectual property, including terms in its trademark, after termination of employment. For more information about how to protect your charity's trademarks, see Nonprofit *Alert*® Memo, *Trademark Law for Nonprofits*. Click here to see a summary of and order this Memo.**

ACLU Challenges Silver Ring Thing

The American Civil Liberties Union ("ACLU") has sued officials of the Department of Health and Human Services ("HHS") in federal court over HHS's grant to the Silver Ring Thing ("SRT"), a faith-based, abstinence-only program. The ACLU claims that HHS's grant to SRT violates the Establishment Clause of the First Amendment.

SRT is a faith-centered program that encourages youth across the nation to abstain from sexual activity until marriage. It does so primarily through a three-hour multi-media presentation that promotes abstinence and, in the second part of the presentation, includes Biblical exhortation and personal testimonies about abstinence. At the end of the presentation, youth are encouraged to purchase and wear silver rings that symbolize their commitment to abstinence. The rings are inscribed with a Bible verse encouraging holiness and discouraging sexual sin.

The ACLU claims that HHS has granted over $1 million to SRT over the past three years that SRT has used to "promote religious content, instruction, and indoctrination," and that SRT "makes no effort to segregate government funds for solely secular uses." The ACLU requests a judicial declaration that HHS's actions violate the Establishment Clause, an injunction prohibiting HHS from disbursing federal funds to SRT, and attorneys' fees.

➥ **Lawsuits against faith-based organizations that receive government funding are becoming increasingly common, as groups such as ACLU and Americans United for Separation of Church and State ("AUSCS") have filed similar suits around the country. For instance, ACLU and AUSCS recently sued the Firm Foundation, a faith-based organization, for using government dollars to pay for an in-prison job-training program that included religious instruction. Generally, courts have found that direct government funding of religious activity violates the Establishment Clause, though some courts have held that such funding does not violate the Establishment Clause if it is provided in a neutral manner, using objective criteria, to serve exclusively secular purposes and ends. For more information on the rights and responsibilities of faith-based organizations that receive government funds, see Nonprofit *Alert*® Memo, *Charitable Choice: Government Funding to Religious Social Service Providers*. Click here to see a summary of and order this Memo.**

House Passes Estate Tax Repeal

The House of Representatives has voted, by a 272-162 margin, to permanently repeal the federal estate tax. The legislation has been sent to the Senate for consideration.

Under current law, the estate tax is scheduled to be repealed in 2010 for one year, then restored in 2011 for estates over $1 million. Until that time, the estate tax exemption threshold per person is scheduled to increase in gradual increments, from its current $1.5 million until it reaches $3.5 million in 2009.

Although the House has passed prior legislation to repeal the estate tax, the Senate has always rejected such legislation. Republican and Democratic Senators are trying to negotiate a compromise bill that would increase the estate tax exemption threshold, but would not repeal the tax

The primary argument for repeal of the tax is that it hurts small businesses and family farmers. Many nonprofit organizations are concerned, however, that repeal of the tax would eliminate a significant incentive for wealthy donors to make charitable bequests. The Congressional Budget Office estimated that repealing the tax on estates would lead to a decline in overall charitable giving of between 6 and 12 percent. CBO estimates that if estate-tax repeal had been in effect in 2000, charitable contributions would have declined by $13 billion to $25 billion for that year. Click here for full CBO study: http://www.cbpp.org/8-3-04tax.htm The Joint Committee on Taxation estimates that repealing the estate tax could decrease tax revenues as much as $290 billion over the next 10 years.

New Nonprofit Mail Ruling Effective June 1st

The U.S. Postal Service has issued a Customer Support Ruling that clarifies when charities may include "personal information" in bulk mailings sent at discounted Nonprofit Standard Mail ("NSM") rates. Last fall, the Postal Service issued a rule, effective June 1, 2005, that "personal information" other than a recipient's name and address may not be included in an NSM bulk mailing unless three conditions are met: (1) the mailing contains explicit advertising for a product or service for sale or lease, or an explicit solicitation for a donation; (2) all of the personal information is directly related to the advertising or solicitation; and (3) the exclusive reason for inclusion of all of the personal information is to support the advertising or solicitation in the mailing.

Mail Ruling....[continued]

In its Ruling, the Postal Service clarified that the term, "solicitation for a donation" encompasses a request for any type of support, both monetary and non-monetary, of the mailer's nonprofit purposes. For example, such solicitations may include a request that the recipient volunteer, pray for, complete a survey for, or attend an event for the nonprofit, or perform services that advance the nonprofit's purposes. The solicitations must contain some kind of call to support those purposes to qualify for the NSM rates.

The Ruling emphasizes that the personal information must be directly related to the solicitation for the mailing to qualify for NSM rates. For instance, the recipient's amount of contributions to the nonprofit will be considered directly related to a solicitation for a donation (*e.g.*, "Thank you for your donations of $___ in previous campaigns").

The Ruling also emphasizes that the exclusive reason for including the personal information must be to support the solicitation. For instance, mailings will not qualify for NSM rates if they include language suggesting that the purpose of the mailing is to substantiate a gift or provide a gift receipt (*e.g.*, "receipt," "tax receipt," "keep this notice for your records"). On the other hand, the Ruling states that the following language may be included in such mailings: "Your contribution may be tax-deductible" and "the IRS requires written substantiation of charitable gifts of $250 or more."

Meanwhile, the Postal Service has proposed a 5.4% increase in NSM rates for 2006. This is a smaller increase than most charities anticipated, but would still result in a significant revenue increase for the Postal Service. The Postal Service processes more than 16 billion pieces of nonprofit mail annually.

The Confederacy Lives: Vanderbilt Must Honor Donor's Confederate Condition

A Tennessee appeals court has ruled that Vanderbilt University may not change the name of its "Confederate Memorial Hall" unless it refunds the present value of the donation that funded the building's construction. The donor, the Tennessee Division of the United Daughters of the Confederacy ("UDC"), filed suit to enforce the name restriction it placed on the gift in 1933.

In 1933, UDC offered the George Peabody College for Teachers $50,000 for the construction of a dormitory, provided that the College comply with certain conditions. The College agreed to provide rent-free housing to female descendants of Confederate soldiers on the first two floors of the building, and to name the building, "Confederate Memorial Hall." In 1979, the George Peabody College merged with Vanderbilt University, whereupon Vanderbilt assumed all of Peabody's legal obligations. In 2002, Vanderbilt's chancellor announced his plan to delete the word "Confederate" from the building, citing the negative implications of the word and its negative impact on Vanderbilt. UDC sued Vanderbilt, and the trial court granted summary judgment for Vanderbilt.

The appeals court reversed the trial court's decision. It held that the contract, comprised of the gift with conditions, must be interpreted "as [it was] written," consistent with the original intent of the parties. The court determined that the parties intended the inscription, "Confederate Memorial" to remain on the building until it was torn down. Thus, the court held that Vanderbilt must either retain that name on the building or refund the present value (in today's dollars) of the donation to UDC

➥**To avoid the conundrum in which Vanderbilt found itself, a nonprofit that accepts a donor-designated gift with name restrictions should consider retaining the right to change such name in exigent circumstances. This is obviously a sensitive area where an important motivation for making such gifts may be memorial naming rights. However, reasonable discussions and provisions at the time of the gift can save future embarrassment and lawsuits. For helpful tips on accepting and administrating restricted and designated gifts, see Nonprofit *Alert*® Memo, *Donor-Designated Gifts: Pitfalls and Provisos*. Click here to see a summary of and order this Memo.**

IRS Issues Clarification on International Grant Rules

Spurred by an increased focus on terrorist activities abroad since 9/11, the IRS has issued a Chief Counsel Advisory memo (IRS CCA 200504031) concerning rules applicable to grants by nonprofit organizations to international recipients. Rather than establishing new rules, the memo synthesizes and clarifies existing grantmaking rules.

The memo clarifies that a section 501(c)(3) entity will not jeopardize its exemption if it makes grants to non-charitable organizations or individuals overseas, so long as it: (1) ensures the grant funds are used in furtherance of the nonprofit's tax exempt purposes; (2) retains control and discretion as to the use of the funds, and (3) maintains records establishing that the funds were used for tax exempt purposes. Substantiation of distributions to *individuals* must include (1) the name and address of each individual, (2) the amount distributed to each individual, (3) the purpose for which the aid was given, (4) the manner in which the individual was selected, and (5) the relationship, if any, between the individual donee and the organization's members, directors, and officers. These criteria apply both to domestic and non-domestic grant recipients.

The IRS memo also clarifies that a tax exempt organization must exercise discretion and control over a contribution designated by a donor for an international beneficiary for that contribution to be tax deductible. Because contributions to a foreign charity generally are not deductible, a domestic charity should not distribute assets to a foreign recipient merely because a donor has requested that the nonprofit do so. Rather, the nonprofit should distribute assets abroad only after determining that such distribution will advance its exempt purposes.

Department of Justice Launches National Sex Offender Public Registry Web Site

The Department of Justice ("DOJ") is designing a national registry web site to allow citizens to more efficiently search existing state sex offender registries. The National Sex Offender Public Registry ("NSOPR") will use the Internet to search for and display public sex offender data from state and territory registries. The technology for NSOPR promises to be both time-effective and cost-effective. Searches on the site will deliver results based on a name, zip code, geographical area, or other query.

(continued on page 6)

Sex Offender Registry.....*(continued from page 5)*

The DOJ will work with states and territories to link their public registries, at no cost, to the national search site. The first goal of NSOPR is to have at least 20 states participating, and the site available for public searches, by mid-July of 2005. The DOJ's press release is available online at: http://www.ojp.usdoj.gov/pressreleases/doj_offenderregistry.htm.

➥**This national registry web site will provide another valuable tool for pre-screening nonprofit employees and volunteers who will be working with children under a nonprofit's care. For counsel on how to best structure your nonprofit's child abuse prevention and screening policies and procedures, contact Scott Ward at sjw@gg-law.com, or (703) 761-5000 x117. See also Nonprofit *Alert*® memoranda on this topic, including *Child Abuse: Preventing the Risk* and *Child Abuse: Screening Nonprofit Workers.* Click here to see a summary of and order this Memo.**

IRS Announces Proposed E-Filing Requirements

Proposed IRS regulations released earlier this year would require certain organizations, including exempt organizations, to file their IRS returns electronically. Under the new rules, organizations that file at least 250 returns (including income tax, excise tax, employment tax, and information returns) annually and annually exceed certain asset thresholds would be required to file these returns electronically.

Of these organizations, exempt entities that have $100 million or more in assets would have to file their Forms 990 or 990-PF electronically beginning in 2006 (for tax year 2005), and exempt entities with $10 million or more in assets would have to file these forms electronically beginning in 2007 (for tax year 2006). Beginning in 2007, private foundations and charitable trusts will be required to file Form 990-PF electronically regardless of their asset size, if they file at least 250 returns.

At a recent IRS hearing on these proposed e-filing regulations, speakers argued that the cost of complying with the new rules would be burdensome. Although the proposed regulations provide that taxpayers may be granted waivers for undue hardship, those regulations also suggest that the *expense* of compliance will not be considered a hardship. Another argument against the proposed regulations is that software programs are not yet capable of handling mandatory e-filing.

➥**Bolstering these arguments is the fact that of the nearly 500,000 exempt organizations now filing Forms 990 annually, only 862 filed IRS forms electronically as of April 17, 2005. For more information on electronic filing, click on the "Charities and Nonprofits" link on the IRS web page, http://www.irs.gov/.**

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.

To Subscribe: The NPA is a free publication with no login or password required. Visit the **Nonprofit Alert Page** to view current and past issues. Send an email to **NPA@GG-Law.com** to be added to the new issue notification email list.

Nonprofit *Alert*®
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