Gammon & Grange, P.C. September/October 2005

Nonprofit *Alert*©

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

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

"Gripe Site" May Use Fallwell.com Domain Name

The Rev. Jerry Falwell cannot stop an individual from using the domain name www.fallwell.com (intentionally misspelled) for a website that criticizes Falwell's views on homosexuality, a federal court has ruled. The Fourth Circuit Court of Appeals held that the individual was using the domain name for legitimate, noncommercial criticism of Falwell's views, and such use did not constitute trademark infringement or cybersquatting.

In February 1999, Christopher Lamparello registered the domain name www.fallwell.com, created a website at that domain name, and used this website to criticize Falwell's views on homosexuality. Falwell sent Lamparello letters demanding that he cease and desist from using the domain name or any variation of Falwell's name. Lamparello then filed a lawsuit against Falwell and Jerry Falwell Ministries, seeking a judgment that the domain name did not infringe on any trademark rights. Falwell filed counterclaims, alleging trademark infringement, unfair competition, and cybersquatting. The trial court found Falwell had common law trademark rights in his name, enjoined Lamparello to cease using Falwell's mark, and required Lamparello to transfer his domain name to Falwell.

The U.S. Court of Appeals for the Fourth Circuit reversed the trial court's decision. It held that there was no "likelihood of confusion" because Lamparello's website was dedicated solely to criticizing Falwell's views. Lamparello was not attempting to steal "customers," and did not benefit financially from his website. The Court also found that Lamparello was not "cybersquatting" because there was no evidence that he registered the domain name with any intent to profit from its use, e.g., he did not try to sell the domain name to Falwell. Rather, his use of the domain name to criticize Falwell's views constituted a "bona fide noncommercial or fair use." Lamparello v. Falwell, No. 04-2011 (4th Cir. 2005).

⇨The law pertaining to use of trademarks as domain names continues to evolve. This decision reflects a trend by courts to permit use of others' trademarks for domain names of noncommercial "gripe" websites that criticize the trademark owner(s). Although organizations cannot stop others from creating such gripe sites, they can minimize the potential for web surfers to accidentally find such sites by registering all domain names that are similar to the organizations' names and trademarks, including:

- at least the three major top-level domains (i.e., .com, .org, and .net; for more caution, also register .info, .biz, and .us)
- common misspellings of names (e.g., "fallwell.com")
- plural and singular forms of names (e.g., "___ministry.com" and "____ministries.com")
- abbreviations and full names (e.g., "ge.com," "generalelectric.com")
- organization name (e.g., "XYZ.com," "XYZcorp.com", "XYZcorporation.com")
- organization name with hyphen (e.g., "XYZ-corporation.com")
- organization name plus the word "sucks" (perhaps the most common domain name for gripe sites, e.g., XYZcorporationsucks.com) and similar pejorative words

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Registration of multiple domain names not only helps prevent gripe sites from using similar names, but is also an effective way of preventing other organizations with similar names from intentionally or inadvertently using domain names similar to those of your organization. Given the relatively inexpensive price of domain name registration, many organizations have found the investment in domain names justified by the significant protection obtained.

In addition, it is recommended that organizations register with the U.S. Patent & Trademark Office all names that they wish to protect as trademarks. Although trademark registration may not prevent legitimate, non-commercial gripe sites, having a registered trademark is a powerful weapon against cybersquatters and others who attempt to profit in some way from the use of an organization's marks as domain names. Nonprofit organizations with prominent, well-known leaders should also consider registering the leaders' names as trademarks. A person's name may be registerable if it is used to identify goods or services provided to the public. For more information on protecting trademarks and domain names, contact Ken Liu at (703) 761-5000 or KEL@GG-Law.com.

Legislation Would Require Massachusetts Churches to Disclose Finances

Under legislation that has been introduced in the Massachusetts Senate, most churches would be required to register with the Massachusetts Attorney General, then file annual reports with the Attorney General that include financial and compensation data.

The bill, "An Act Relative to Charities in Massachusetts" (S.B. 1074), was introduced in response to concerns by members of the Catholic Church who desire more information about the financial health and holdings of the Archdiocese of Boston. In the wake of the clergy abuse crisis, the Archdiocese is in the process of closing 83 parishes.

Currently, most nonprofit organizations are required to register with the Attorney General and file an annual 13-page registration statement. This statement includes questions about revenues and expenses, the total compensation provided to the organization's five highest paid employees, banks in which its funds are deposited, solicitation practices, and transactions with interested parties. Churches are currently exempt from these registration and filing requirements, as are charities with less than $5,000 in annual revenues. Under the bill, the church exemption would be eliminated.

The Archdiocese of Boston has kept a low profile on the legislation, and promised greater transparency regarding its finances. The Massachusetts Council of Churches, an umbrella organization representing about 1,700 non-Catholic Christian congregations, has been more outspoken. It opposes the legislation on the grounds that it would impose an excessive burden on churches, and that it would violate the constitutionally-protected religious liberty of churches to govern themselves.

⇨This bill reflects a growing trend among states, in the wake of the federal Sarbanes-Oxley legislation, to enact laws regulating charities' financial practices. For instance:

⇨California's Nonprofit Integrity Act, which went into effect earlier this year, requires nonprofits in the state with annual revenues of at least $2 million to have an audit prepared by an independent CPA, overseen by an audit committee, and filed with the California Attorney General's office.

⇨In June, Connecticut passed a law requiring charities to submit a financial report annually to the state Department of Consumer Protection. A Connecticut nonprofit whose revenues exceed $200,000 must also file an audited financial statement with the Department.

⇨A new Kansas law passed in May requires charities to submit a tax return to the Secretary of State before soliciting funds. Charities with annual revenues exceeding $500,000 must submit an audited financial statement to the Secretary of State.

These initiatives are running parallel to the Senate Finance Committee's efforts to develop legislation that would tighten restrictions on tax exempt organizations. See July / August 2005 Nonprofit *Alert*®, May / June 2005 Nonprofit *Alert*®, March / April 2005 Nonprofit *Alert*®, and January / February 2005 Nonprofit *Alert*® for more related information.

IRS Publication on Disaster Relief Available

For legal guidelines on how your charity can assist victims of Hurricane Katrina and other natural disasters, see IRS Publication 3833, Disaster Relief, available at http://www.irs.gov/pub/irs-pdf/p3833.pdf.

HHS Suspends Funding of Silver Ring Thing

The Department of Health and Human Services ("HHS") has suspended its grant to the Silver Ring Thing ("SRT") abstinence program because of allegations that SRT has not adequately segregated its grant funds, resulting in federal funding being applied to both secular and religious activities.

As reported in the May / June 2005 Nonprofit *Alert*®, SRT is a faith-based program that encourages youth to abstain from sexual activity until marriage. It does so primarily through a three-hour, multi-media presentation promoting abstinence. 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. SRT has received approximately $1.1 million in grants from HHS since 2003.

Earlier this year, the American Civil Liberties Union ("ACLU") sued HHS over HHS's grant to SRT, claiming that the grant violated the Establishment Clause. Specifically, the ACLU alleged that SRT used the HHS grant to promote religious content and indoctrination, and made no effort to segregate the funds for solely secular uses.

In August, an associate commissioner for HHS wrote that the SRT "may not have included adequate safeguards to clearly separate in time or location inherently religious activities from the federally funded activities," and that SRT's funded project "includes both secular and religious components that are not adequately safeguarded." HHS ordered SRT to submit a "corrective action plan" outlining how it will separate these religious and secular components so that federal dollars only fund the latter. SRT may become eligible to receive additional federal funds (e.g., a $75,000 grant this year) if it timely submits a plan that is satisfactory to HHS.

Joel Oster, senior litigation counsel at the Alliance Defense Fund, which is representing SRT in the ACLU case, responded to HHS's charges by stating, "Any religious teaching that goes on is separate in time and place from what the government is funding. . . [SRT] offer[s] a religious program and they offer a secular program; kids can choose which one they want to go to." (Washington Post, Aug. 23, 2005). The ACLU declared a partial victory, but said that it would continue to monitor the group's activities. Its lawsuit against HHS is still pending in federal court.

> ⇨ Faith-based organizations receiving government funding must ensure that adequate safeguards, including capital accounting and segregation of accounts, are in place and carefully followed. If a faith-based organization is contemplating receiving federal, state, or local grants, there are well established accounting and operational safeguards to assure effective segregation of government funds for non-sectarian programs and activities. For more information, contact Steve Clarke (SMC@GG-Law.com or 703-761-5000 x141) or Steve Kao (SSK@GG-Law.com or 703-761-5000 x129).

Credit Union Assumes Liabilities Upon Merger, Avoids Liability for Employment Termination

The Indiana Court of Appeals has held that a credit union that purchased all assets from another credit union upon dissolution assumed all of the dissolved credit union's liabilities, because their arrangement was a de facto merger. However, the Court also held that the surviving corporation was not liable for damages resulting from the dissolved credit union's termination of its general manager, because the dissolved credit union's board of directors had exercised due care in deciding to terminate the employee.

Prior to its dissolution, LTV Steel Employees Federal Credit Union ("LTV") hired a general manager. The GM's contract stated that LTV, a nonprofit corporation, could terminate her employment for "material breach" of the contract, or negligent or willful misperformance of her duties under the contract, after giving her notice of the charges against her and an opportunity to respond at a board meeting. When the LTV board determined that its GM had failed to perform her duties, it notified her of her pending termination. The board cited the GM's signing a marketing agreement that would benefit her son, without receiving approval to do so; extending loan repayment terms for

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members of the credit union with whom she had personal relationships; contravening orders of the board that LTV perform its own collections work; and missing over 100 days of work during the course of a year. The GM sent a written response to these charges. The LTV board found her responses inadequate, and terminated her employment.

Shortly after this termination, LTV sold all of its assets to Tech Credit Union Corp. ("Tech") pursuant to an "Agreement of Merger" that stated LTV "shall be merged into TECH Credit Union under the name and charger of TECH Credit Union." The agreement did not address whether Tech would acquire LTV's liabilities. Upon sale of its assets to Tech, LTV filed dissolution papers with the state and went out of business.

The former GM filed a complaint against Tech and the LTV board members, alleging breach of and tortuous interference with her employment contract. The trial court granted Tech's motion for summary judgment, holding that it did not become a successor to the employment contract. It also granted the LTV board members motion for summary judgment, holding that they exercised their business judgment in good faith.

On appeal, the Indiana Court of Appeals overruled the trial court and ruled that Tech did indeed acquire the liabilities of LTV. The Court acknowledged the general rule that when one corporation purchases the assets of another, the buyer does not normally assume the debts and liabilities of the seller. One exception to this rule, however, is when the transaction is a de facto consolidation or merger. Here, the Court found the LTV-Tech transaction to be a de facto merger, since the parties' "Agreement of Merger" used merger language throughout. Thus, the Court held that Tech assumed all of LTV's debts and liabilities, including any liabilities that LTV may have for wrongful termination of employment.

The Court upheld the lower court's ruling that the LTV directors were not liable for wrongful termination, since they exercised good faith and acted in the best interests of the corporation in doing so. The directors identified specific failures of the GM to exercise her contractual duties, and followed due process before terminating her, as required by her employment contract. Rodriguez v. Tech Credit Union Corp., et al., No. 45A04-0409-CV-470 (IN. App. Ct. 2005).

⇨Consolidation can take numerous forms; one size does not fit all. If a nonprofit is acquiring a for-profit corporation that is set up with membership interests or stock, a stock acquisition is an option. In that case, the acquired entity would become a subsidiary of the nonprofit with all assets and liabilities transferring intact–including any inchoate assets and liabilities. Another option is an asset acquisition, which allows the acquiring entity to cherry pick certain assets and liabilities, which is typically followed by a dissolution of the entity whose assets have been transferred. A statutory merger involves a transfer of all assets and liabilities, including inchoate assets such as future and testamentary gifts to the merged entity. Of course, all liabilities, including unasserted and unknown liabilities at the time of the merger, also transfer to the surviving entity. Various hybrids of these consolidation forms, such as the one litigated above in the Indiana court, are also possible. Consolidation due diligence should focus not just on what is currently on a consolidating entity's balance sheet, but also on inchoate assets and unasserted liabilities and claims. For more information, contact Steve King (SHK@GG-Law.com or 703-761-5000 x. 121).

Despite Tech's assumption of LTV's liabilities, Tech avoided liability for wrongful termination because the LTV directors properly exercised their duty of care in terminating their GM. For more information on the duty of care and other legal responsibilities of nonprofit directors, see Nonprofit *Alert*® Memo, Directors' Nonprofit Legal Duties. (click here to order)

Benny Hinn Ministries Faces Local and Federal Scrutiny

Benny Hinn Ministries ("BHM"), the organization founded by televangelist and faith healer Benny Hinn, is under investigation by both the IRS and Tarrant County, Texas, where BHM's world headquarters is located. The IRS has launched an inquiry into whether BHM qualifies as a tax exempt "church," while the Tarrant Appraisal District is questioning whether BHM's headquarters should continue to enjoy property tax exemption.

According to the Dallas Morning News, the IRS investigation of BHM began last summer, when the religious charity watchdog group Wall Watchers complained to the IRS that BHM lacked independent governance and financial oversight. Wall Watchers also claimed that BHM was set up fraudulently as a "church." Subsequently, the IRS sent BHM an inquiry letter containing over 30 questions regarding its operations, governance, for-profit affiliates, and compensation practices.

According to the Trinity Foundation ("TF"), a televangelist watchdog group, Hinn selects BHM's Board, controls its finances, and receives over $1.3 million in annual compensation from BHM. TF also alleges that BHM has paid Hinn an additional $360,000 as a consultant for Clarion Call Marketing, and paid more than $112,000 a month on a 10-year lease of a Gulfstream III jet used by Hinn. In an interview with Dallas Morning News, an IRS spokesperson confirmed that the IRS is conducting an inquiry of BHM. Without providing details, the spokesperson stated that such inquiry is "extremely sensitive." (Dallas Morning News, July 6, 2005)

Meanwhile, the Tarrant Appraisal District is reconsidering the property tax exemption of BHM's $6.5 million world headquarters in Tarrant County. The County granted the exemption to BHM in 2003 on the basis that the property is used as a "church." Under County rules, an organization's property can qualify as a "church" if it is used primarily as a place of regular religious worship. According to the Fort Worth Star-Telegram, the BHM headquarters is a traditional corporate office facility used primarily for administrative purposes, and does not offer public worship services.

A BHM spokesperson defended the BHM headquarters' property tax exemption, explaining that the "underlying religious purpose at our property in Grapevine is that of a church religious organization with religious beliefs and religious services." He explained that all BHM employees at the facility engage in "some form of organized worship, fellowship, prayer and biblical study at the [] property on almost every business day." BHM also acknowledged that it is under investigation by the IRS, but described the investigation as "routine." (Fort Worth Star-Telegram, Aug. 13, 2005)

> ⇨ Nonprofit organizations are prohibited from generating private benefit to outsiders or private inurement to insiders (e.g., directors, officers, managers), including unreasonable compensation. For purposes of determining reasonable compensation, the IRS considers all benefits provided by the nonprofit to its insider, including fringe benefits, personal use of the nonprofit's resources (e.g., houses, vehicles), and payments to the insider's family members or businesses owned or controlled in part or whole by the insider. Any such private inurement, or "excess benefit," to an insider can result in the IRS imposing Intermediate Sanctions excise taxes against the insider and the organization's directors or managers who approved the transaction. To avoid paying unreasonable compensation, generating private inurement, and incurring Intermediate Sanctions, read Nonprofit *Alert*® Memos, Private Inurement: Essential Dos and Don'ts, Compensation Policies & Legal Guidelines for Nonprofit Leaders, and Intermediate Sanctions Law. (click here to order)

IRS Determines That A "Church" Is Not a Church

A group that holds Sunday services and Bible studies every week is not a church, according to a recent IRS ruling.

The group applied for IRS recognition of exemption from federal income tax as a church. It distributed free Bibles at its weekly worship services and received donations from attendees. The group submitted its pastor's certificate of ordination to the IRS, and described him as having the "Biblical marks of a pastor." Yet, the IRS found that the group lacked the marks of a true church.

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While the IRS has no official definition for the term "church," it considers14 criteria in determining whether an entity is a church (see http://www.irs.gov/pub/irs-wd/0502044.pdf). The presence or absence of any one of these factors is not by itself determinative. Instead, the IRS applies all 14 criteria and considers other relevant facts and circumstances in determining church status.

The IRS described eight problem areas that contributed to the group's disqualification from exempt status as a church: 1) it had no regular congregation and lacked requirements for membership; 2) attendees were not expected to view the organization as their exclusive church and could remain members of other churches; 3) the group was governed only be a self-perpetuating 3-person board, including the pastor; 4) the group lacked any prerequisite training regimen for pastoral ordination; 5) the group performed no baptisms, weddings, funerals, or any other traditional sacerdotal rituals; 6) the group had no written policies to guide financial decisions; 7) the group provided no regular instruction or religious education for children; and 8) the group disseminated no established doctrinal literature. PLR 200502044.

⇨ Under Section 508 of the Internal Revenue Code, "churches, their integrated auxiliaries, and conventions or associations of churches" are automatically exempt from federal income tax. However, a group's self-description as a "church" is not sufficient, in and of itself, to qualify a group for tax exempt status. If the IRS should challenge the bona fides of a church that has not sought IRS confirmation of its exempt status, the church will have to demonstrate not only that it conducts regular religious services, but also that it satisfies many other of the 14 criteria. For more information on qualifications for church status, benefits available to churches, and related issues, read Nonprofit Alert® Memo, Criteria for Qualification as a Church. (click here to order)

IRS Seeks Comment on Revised Forms 990; Releases New Vehicle Contribution Form

The IRS is seeking comment on draft revisions to several forms filed by tax exempt organizations, including Form 990-EZ and Schedule A of Form 990, The IRS has also released and received comments on a draft Form 1098-C for reporting vehicle contributions.

A revised Schedule A to the Form 990 requests charities to disclose their five highest paid independent contractors for the reporting period, and to list the contractors' addresses, types of service provided, and compensation. The revised Schedule A also includes a new question intended to curb the abuse of conservation easements: "Did the organization receive a contribution of qualified real property interest under section 170(h)?"

The revised Form 990-EZ includes a new question about a charity's interest in any foreign funds: "At any time during the calendar year, did the organization have an interest in, or a signature or other authority over, a financial account in a foreign country (such as a bank account, securities account, or other financial institution?" If the charity answers yes, it is required to list the names of countries in which it has such an interest.

Charities must file a Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes, with the IRS after accepting a charitable donation of a vehicle (see July / August 2005 Nonprofit Alert®). The draft version of this Form requires a charity to disclose information about the donated vehicle, the donor, the date of sale (if any), the amount of sales proceeds (if any), whether the vehicle is transferred for money or other property, whether it is transferred to a needy individual for significantly below fair market value, and what use the charity made or plans to make of the vehicle (if any). The IRS has received and is considering comments on this Form (the comment period ended September 1, 2005).

These forms may be reviewed at www.irs.gov/charities.

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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