

# nonprofit Navigator

## Campaign Finance Reform Takes on 527 Organizations New Disclosure Law Brings Some Transparency to Secretive Tax-Exempt Groups

**O**n July 1, 2000, President Clinton signed legislation (H.R. 4762) that mandates increased disclosure by political organizations formed under Section 527 of the Internal Revenue Code.

H.R. 4762 requires certain 527 organizations to register with the IRS and file annual returns. In addition, some of these organizations must file periodic disclosure reports with the IRS detailing contributions and expenditures. This article describes the registration and disclosure requirements contained in the legislation.

For readers unfamiliar with the term, 527 organizations are named after the section of the Code from which they derive their tax exemption. Section 527 of the Code describes the taxation of political organizations whose primary purpose is to accept contributions or make expenditures for an “exempt function”—trying to influence the nomination, election, selection, or appointment of an individual to local, state, or federal office. Section 527 covers political parties, candidate committees, and state or federal PACs. It also includes organizations, such as Republicans for Clean

Air, that have received media attention this election year because of their ability to raise unlimited funds for political activities without having to disclose any details about their operations under the election law.

*The rush to put out some campaign finance reform measures before November could explain the ambiguity of certain provisions.*

### Registration Requirements

Many 527 organizations have been able to avoid any registration requirements by conducting activities that, although considered “political” for tax purposes, are not regulated by the federal or state election laws. Under the new legislation, however, all 527 organizations formed before July 1, 2000 that wish to be treated as such must have registered by July 31, 2000 with the IRS. 527 organizations created after July 1, 2000 must file within 24 hours of their formation. Failure to comply with registration requirements will result in the

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# Capitol Letters

## Options for Cybersquatting Victims What to Do When Your Domain Name is Stolen

In today's high-tech Information Age, cases of Internet domain name infringement are becoming increasingly commonplace. Nonprofit organizations should not consider themselves immune to the threat of cybersquatting. Fortunately, last year two separate remedies became available for nonprofits victimized by cybersquatters. The first is a special administrative procedure adopted by the Internet Corporation for Assigned Names and Numbers (ICANN), which administers the largest and most common domain names (including .com, .net and .org); the second option is court litigation.

ICANN's Uniform Domain Name Dispute Resolution Policy (UDRP), which went into effect on August 26, 1999, provides for the mediation and resolution of domain name conflicts between two parties by a single- or three-person administrative panel appointed by a dispute-resolution service provider. A unique feature of this arbitration is that the entire proceeding takes place via electronic means of communication. Except in unusual circumstances, there are no in-person hearings, eliminating the logistic difficulties of bringing the parties together in the same physical space. Unlike a court, ICANN does not need to establish personal jurisdiction over the two parties; geography is not an obstacle. It is just as easy for a plaintiff to initiate the UDRP against a cybersquatter in Japan as against a domestic cybersquatter. Although the administrative panel may only rectify the complainant's damages by transferring the contested domain name to the complainant or canceling the cybersquatter's domain name registration altogether, the UDRP is an attractive option for smaller nonprofits who need to settle domain name disputes quickly and cheaply. As opposed to a litigation

settlement, the average UDRP proceeding lasts about two months; and at the cost of a few thousand dollars to cover the service provider's fee, the UDRP is also much less expensive. (Information on UDRP is available on ICANN's website at <<http://www.icann.org>>.)

Nevertheless, the UDRP is not the best solution in every case involving domain name disputes. UDRP cannot be invoked in every case of cybersquatting because it is only available in disputes involving the .com, .net, and .org domain names, which means that cases associated with other domain names must be resolved in court. Furthermore, a dispute settled under UDRP cannot prevent one of the two parties from seeking post-UDRP litigation. Such litigation is a second, independent option available to organizations victimized by cybersquatting. The Anticybersquatting Consumer Protection Act (ACPA), which Congress ratified as an amendment to U.S. trademark law, went into effect on November 29, 1999. More practical for complex cases involving factual disputes than the streamlined UDRP, the ACPA allows the plaintiff to sue in federal court for damages or the alleged cybersquatter's profits, as well as for the transfer or cancellation of the offending domain name registry. The plaintiff also maintains the option of recovering statutory damages of between \$1,000 and \$100,000 from the defendant, compensation that is unavailable under the UDRP. On the downside, litigation under the ACPA is time consuming and probably too costly for many nonprofits. Furthermore, as with all litigation, the court must establish personal jurisdiction over the two parties, making it more difficult—though not impossible—to prosecute foreign cybersquatters.

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organization's loss of tax exemption. [See box for registration requirements.] Organizations with annual gross receipts of \$25,000 or less and political committees that already report to the FEC under federal election law are not required to register. In addition, 501(c) organizations that conduct political activities using their general treasury funds are not required to register.

The IRS has posted the registration form, Form 8871, on its web site at <[www.irs.gov/forms\\_pubs/forms.html](http://www.irs.gov/forms_pubs/forms.html)>. Registration notification must be filed both electronically at <[www.irs.gov/bus\\_info/eo/pol-file.html](http://www.irs.gov/bus_info/eo/pol-file.html)> and in writing at the Internal Revenue Service Center, Ogden, UT 84201.

Beginning August 15, 2000, the IRS is required to make available on the Internet a list of all political organizations that have registered, including the name, address, electronic mailing address, custodian of records, and contact person for each organization.

### Disclosure Requirements

#### Annual Returns:

Prior to the passage of H.R. 4762, the only tax return 527 organizations were

**527 organizations that register with the IRS must provide the following information:**

- the name and address of the organization (including any business address, if different) and its electronic mailing address;
- the purpose of the organization;
- the names and addresses of its officers, highly compensated employees, contact person, custodian of records, and members of its Board of Directors; and
- the name and address of, and relationship to, related entities.

required to file was Form 1120-POL, which reports investment income or nonexempt function expenditures in excess of \$100. Under the new legislation, all 527 organizations with annual gross receipts of \$25,000 or more, including federal PACs that already report to the FEC, also must file and make publicly available Form 990, the annual return filed by 501(c) organizations. This annual return requirement will apply to returns for taxable years beginning after June 30, 2000.

*Critics say that this legislation is only a small step toward real campaign finance reform.*

#### Periodic Returns:

In addition to annual returns, most 527 organizations now have to file periodic reports

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**Periodic reports filed by 527 organizations must list the following information:**

- the amount of expenditures (aggregated) of \$500 or more made to any person in a calendar year and the name and address of the recipient of each expenditure (including occupation and name of employer if the recipient is an individual); and
- the name and address of all contributors who contributed an aggregate amount of \$200 or more to the organization during the calendar year, the amount contributed, and the contributor's occupation and employer.

The reporting requirements apply to all expenditures made and contributions received after July 1, 2000, with the exception of those made or received after July 1, 2000 pursuant to a contract entered into on or before July 1, 2000.

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with the IRS along a federal election cycle, using form 8872. [See boxes for reporting requirements and filing options.] Political committees required to report under federal election law, however, are exempted, as are

state or local committees of a political party, political committees of state or local candidates, organizations with gross receipts of \$25,000 or less for any taxable year, and 501(c) organizations that pay taxes on political activities under Section 527. Notably, there is no exception for state PACs other than parties and candidates. It is unclear whether PACs with both federal and non-federal accounts are required to register their non-federal 527 fund or report on their activities.

The legislation further provides that the periodic report requirements do not apply to independent expenditures. However, the ambiguous language of the legislation leaves it uncertain whether this independent expenditure exception covers state and local races or only federal elections.

H.R. 4762 provides for the public availability of these periodic reports. Like the Form 990, these reports must be available for inspection in the 527 organization's principal office. In addition, 527 organizations must provide photocopies of all of these documents upon request. Unlike the contributor information listed in reports filed with the FEC,

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### 527 organizations required to file periodic returns may choose between two filing options:

*Option 1.* In calendar years in which regularly scheduled federal elections are held, the organization must file quarterly reports beginning with the first quarter of the calendar year in which a contribution is accepted or expenditure made. In any other calendar year, the organization must file bi-annual reports. Under this option, a political organization that accepts a contribution or makes an expenditure in July of this year will have to report this information no later than October 15 of this year.

In addition to the quarterly report, organizations making expenditures or accepting contributions in connection with a federal election—including primaries, presidential nominating conventions, and special elections—must file a pre-election report no more than twelve days before the election, covering the period up to twenty days before the election as well as a post-general election report.

*Option 2.* An organization may choose to file monthly reports beginning in the first month in which a contribution is accepted or expenditure is made. In calendar years in which a regularly scheduled federal election is held, organizations accepting contributions or making expenditures must file a pre-general election report and a post-general election report in lieu of reports that would be due in November and December. In addition, a year-end report must be filed each January. Note that this filing option does not require organizations to file other pre-election reports.

### Which Reporting Option is Best for Me?

Considering the broad definition of federal elections under the legislation, organizations active in federal elections may find Option 2 to be less cumbersome. This is because under Option 1, an organization involved in federal primaries in ten states, for example, would have to file a pre-election report twelve days prior to each primary in addition to quarterly and post-election reports. Under Option 2, only one pre-general election report would be due in addition to the monthly, post-general election and annual reports. For organizations active only in state or local elections, Option 1 is likely to be most attractive.

## Court Lessens Employee Burden in Age Suits Under ADEA, Employees Need Not Show Direct Evidence of Discriminatory Intent

In a June 12 decision, the Supreme Court said that employees don't have to present direct evidence of an employer's discriminatory intent in age discrimination cases, thus making it easier for them to prove bias. The case, *Reeves v. Sanderson Plumbing Products*, clarified what type of evidence employees to prove bias.

Roger Reeves, a 57-year-old supervisor who had worked for 40 years at Sanderson Plumbing Products, a firm that manufactured toilet seats, was fired for inadequately keeping employees' time records and not disciplining them for absenteeism. He was replaced by three successive employees in their 30s. Reeves then filed a suit under the federal Age Discrimination in Employment Act (ADEA). At the trial, he presented evidence to show that the recordkeeping errors were made by other employees or the result of a timeclock malfunction. Reeves also argued and that the company's stated reasons for firing him were a pretext. He claimed he received harsher treatment than younger workers and that several months before he was fired, the company's director of manufacturing (who was one of three managers who recommended that Reeves be fired) said Reeves was so old he "must have come over on the Mayflower" and that he was "too damn old to do the job"

In response, the company argued that the manufacturing director's comments were not directly made in the context of Reeves' termination, that other workers covered by the ADEA (those 40 and over) were fired, and that 20 management positions were held by people over 50.

A jury found that the company's age discrimination had been willful and awarded Reeves almost \$100,000 in damages. The U.S. Court of Appeals for the 5<sup>th</sup> Circuit reversed, holding that Reeves did not present enough

evidence for the jury to have concluded that his age was the basis for Sanderson's employment decision. Although Reeves had shown that Sanderson's explanation for his firing was a pretext, Reeves still had to show that he had been fired because of his age, the appeals court said.

*The company argued that the manufacturing director's comments were not directly made in the context of Reeves' termination.*

The Supreme Court took the case to resolve a conflict among the appeals courts over what amount of evidence an employee had to present to show intentional discrimination. In contrast to the 5<sup>th</sup> Circuit, other federal appeals courts had decided that a finding of discrimination was supported just by an employee's showing that the employer's explanation was not credible: that is, additional direct evidence of age discrimination was not necessary for the employee to win the case.

In a unanimous opinion by Justice O'Connor, the Court said that the 5<sup>th</sup> Circuit was wrong and that Reeves *had* presented enough evidence to prove his case under the ADEA. To find intentional age discrimination by the company, Reeves had to do things: First, he needed to establish a "prima facie" case of age discrimination (i.e., by showing that he was over 40, that despite his qualifications for the job, he was fired, and that he was replaced by younger workers). Second, he had to cast enough doubt on his employer's explanation of his firing (shoddy recordkeeping) to permit a reasonable jury to reject it. Reeves did not *also* have to present proof of the employer's illegal bias, as the

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# UBIT Update

## Tea and Trinkets: A Recipe for UBIT

### Activities “Further” But Are “Unrelated To” Exempt Purposes

In a recent technical advice memorandum, the Internal Revenue Service ruled that income derived from a 501(c)(3)'s supporting gift shop and tea room—some 62 percent of the group's total revenues—constituted unrelated business taxable income but did not endanger the organization's exemption. Despite this high proportion of UBTI, the Service found that the organization's primary purpose was to serve needy women and therefore entitled to tax exemption.

The Women's Exchange helps needy women to earn a living by selling their crafts on a consignment basis. In addition to maintaining the storefront, the organization provides its beneficiaries with materials and training. Central to the group's strategy is a gift shop, contiguous to the consignment shop, which provides both an additional revenue stream for the organization and broadens the available items and prices, thereby attracting more patrons by avoiding a “craft fair” atmosphere.

The organization prices its gift shop items below and above those of the consignment shop items so patrons are attracted to the complex by the lower-priced items, but purchase the consignment items, thinking they have discovered a bargain in relation to the higher priced gift-shop items. A “sophisticated and tasteful” tea room, also contiguous to the consignment shop and accessible only through the gift shop, also serves as an attraction for the consignment shop. Since inception, the Women's Exchange has reported its gift shop and tea room revenue on form 990-T and paid unrelated business income tax.

Drawing on a long string of revenue rulings permitting charitable organizations to

operate gift shops and restaurants for revenue-raising purposes, the IRS determined that the gift shop and tea room operations did not conceal a substantial non-exempt purpose. However, as there was no causal relationship between the gift shop and tea room and the accomplishment of the organization's exempt purpose, the income was subject to UBIT.

*The question raised on audit implicated the organization's 501(c)(3) eligibility.*

This result was apparently mandated by a 1973 revenue ruling which determined that the sale of scientific books and souvenirs in an art and history museum gift shop was unrelated to the purpose of promoting the arts. As for the tea room, the Service further distinguished a later revenue ruling which did not apply UBIT to a museum cafeteria by noting that unlike that situation, in which the eatery was only accessible through the museum and catered only to museum patrons and employees, the tea room competed with other restaurants, used profit-making pricing formulas and had hours of operation competitive with other commercial enterprises.

In a confusing conclusion, the Service conceded that the sale of gift shop items and the operation of the tea room increased the sale of consignment shop items, and thus helped the organization achieve its exempt purpose of helping needy women. Nevertheless, the IRS ruled that their sale generated UBTI because the specific items sold had no causal relation to the exempt purposes of the organization.

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# Congress Inks Electronic Signature Legislation

## New Law Upholds Legality of Electronic Signatures Used in Commerce

The President recently signed into law the Electronic Signatures in Global and National

Commerce Act which makes legally binding electronic signatures and electronic contracts used in domestic and global commerce. The law, which encourages states to enact consistent laws by preempting inconsistent laws, prohibits states from denying legal effect to certain transactions simply because they are conducted electronically. Although the law has been called one of the biggest economic bills of the 106<sup>th</sup> Congress, its practical impact on nonprofits will be limited.

Recently, nonprofits have begun to consider how electronic signatures can be used in the conduct of their internal business. Can Board members, for example, conduct a vote for action electronically without a meeting? Nonprofits will be disappointed to learn that the new legislation does not apply to internal business such as this. The types of transactions covered by the legislation are limited to commercial transactions such as the sale of goods and services. However, in an effort to protect consumers, the legislation does not apply to notices of cancellation of utility services, termination of health benefits, product recalls, and eviction. In addition, certain transactions and records governed by estate and family law, as well as documents connected with court proceedings and filings with federal and state agencies are exempted from the legislation.

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### Court Lessens Employee Burden, cont.

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Fifth Circuit had held. "In appropriate circumstances," the Supreme Court said, a jury "can reasonably infer from the falsity of the explanation that the employer is dissembling to cover up a discriminatory purpose. . . . Moreover, once the employer's justification has been eliminated, discrimination may well be the most likely alternative explanation, especially since the employer is in the best position to put forth the actual reason for its decision."

Nonprofits should be aware that the new legislation allows them to use electronic signatures in their commercial dealings. The legislation allows private parties to determine what constitutes an electronic signature. If nonprofits do not wish to conduct their commercial business electronically, they can still require hard copies.

The law will become effective October 1, 2000.

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### Campaign Finance Reform, cont.

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however, this legislation does not protect the names and addresses of contributors provided in these periodic reports from sale or use for commercial or fundraising purposes.

#### What's Due For This Year's General Election?

In addition to periodic reports, organizations making expenditures or accepting contributions in connection with this year's general elections must file a pre-election and post-general election report. The pre-election report will be due October 26 and must cover the period of October 1 through October 18. The post-general election report will be due December 7 and must cover the period October 18 through November 27.

The Court's decision will make it easier for employees to show that they were discriminated against, or at least make it easier for them to get a jury to hear their claims, by casting doubt on the reasons an employer gives for a termination or other employment decision. In addition, the Court's holding will be applied to other types of discrimination cases, not just those involving claims of age discrimination.

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## Getting to Know Harmon, Curran, Spielberg & Eisenberg, LLP

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- Editor, *Nonprofit Navigator*, formerly *Tax Monthly for Exempt Organizations* and *Tax Monthly for Associations*

Gail is a nationally recognized authority on exempt organization law, having advised in this field for 20 years. She provides strategic advice to a wide range of progressive foundations, charitable and lobbying organizations, associations, and political action committees on federal tax law, federal election law, and other legal issues. Gail is a frequent speaker, writer and commentator on issues affecting the nonprofit sector and an active participant with the legal and nonprofit community in developing the law in this area.

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