

Navigating Nonprofit Partnerships, Joint Ventures & Commercial Co-Ventures: How Arts Organizations Can Avoid the Legal Pitfalls

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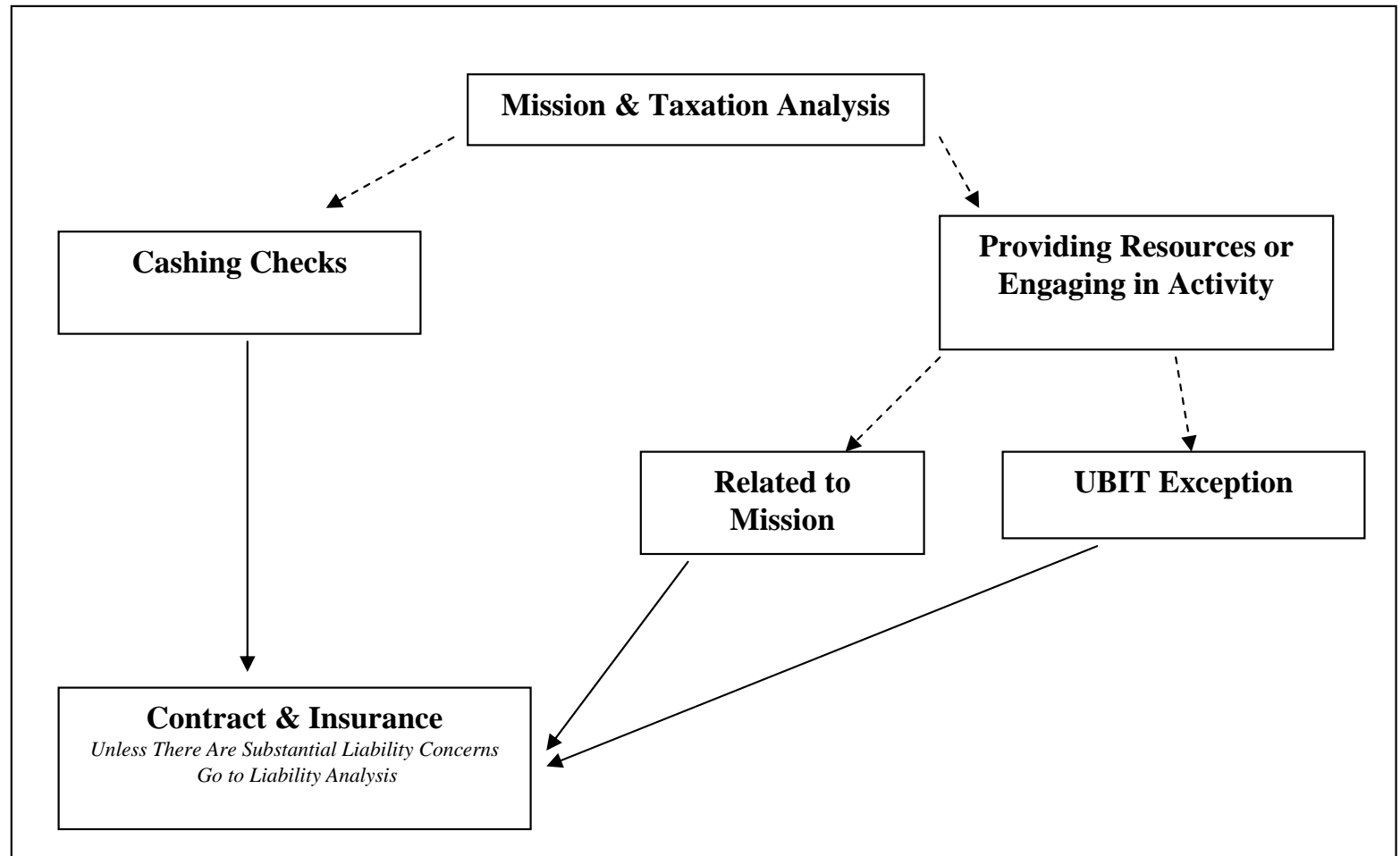


Overview

- **Promotional and Fundraising Affiliations**
 - Corporate Sponsorships
 - Licensing (Passive Royalty Income)
 - Commercial Co-Venture
- **Joint Activities**
 - Joint Programs Via Contract
 - Subsidiary Entities
 - LLCs
 - Corporations



Managing Non-Taxable and Low-Risk Activities



Fundraising and Promotional Affiliations



Corporate Partnerships Maximizing Income

Qualified Sponsorship Payments

- Goods or services, or other benefits, the total value of which does not exceed **two percent** of the sponsorship payment; and
- **Recognition**, i.e., use or acknowledgment of the sponsor's name, logo, or product lines in connection with the nonprofit's activities



Corporate Sponsorship Income

Permissible forms of use or acknowledgment:

- Use or acknowledgment of the **name or logo** (or product lines) of the sponsor's business, as long as use is not qualitative or comparative
 - List of **sponsor's location, telephone number**, and/or internet address, including a **hyperlink** from the exempt organization's web site to the sponsor's web site
 - Product **samples okay**
- Unlike Sponsorship Payments, Payments Received for **Advertising are Characterized as UBI**
 - Characteristics of Advertisements Include:
 - **Comparative or qualitative language**
 - **Price, savings or value information**
 - **Endorsements**
 - **Inducement to buy**



Licensing Arrangements

- Name, mark and mailing list
- Other Intellectual Property
 - Recordings, Reprints
- No active promotion (or quantify value and pay tax)
 - Announcement letter okay
 - Quality control measures okay



Commercial Co-Ventures

- **Commercial Co-Venture (“CCV”)** – An arrangement between a charity and a commercial entity under which the commercial entity advertises in a sales or marketing campaign that the purchase or use of its goods or services will benefit a charity or charitable purpose
- *“When you buy our new iPhone app, 50% of the purchase price will go to the Lincoln Center!”*
- Frequently referred to as “charitable sales promotions” or “cause-related marketing”
- Excellent fundraising and marketing mechanism for both the charity and commercial co-venturer



Regulation of Commercial Co-Ventures: State Law

- More than 40 states have laws that regulate various methods of fundraising, including charitable solicitations and CCVs
- About 20 states have laws that specifically regulate CCVs
- Purpose of laws – consumer protection
- Ex: General Mills/Yoplait “*Save Lids to Save Lives*” campaign in late 1990s to Benefit Breast Cancer Research Foundation
 - GA Secretary of State concluded that the disclosures regarding the donation amount were misleading to consumers (GA Secretary of State press release: <http://sos.georgia.gov/pressrel/pr991221.htm>)



Regulation of Commercial Co-Ventures: State Law

- Statutory language and requirements vary by state → **always check language of the statute**
- NY definition of “commercial co-venturer” is fairly standard:
 - “Any person who for profit is regularly and primarily engaged in trade or commerce other than in connection with the raising of funds or any other thing of value for a charitable organization and who **advertises that the purchase** of goods, services, entertainment, or any other thing of value **will benefit a charitable organization.**” [N.Y. Exec. Laws § 171-a]
- Compare with broader MA statute:
 - “[A]ny person who for profit or other commercial **consideration** conducts, produces, promotes, underwrites, arranges or **sponsors a performance, event, or sale** to the public of any good or service which is advertised in conjunction with the name of any charitable organization or **as benefitting to any extent any charitable purpose.**” [Mass. Gen. Laws ch. 68, § 18, 22-28]



Regulation of Commercial Co-Ventures: State Law

- State Law Requirements, Generally:
 - *Registration*
 - *Bonding*
 - *Written Contract*
 - *Advertising Disclosures*
 - *Accounting & Recordkeeping*
- **Registration** – Several states require advance registration by co-venturer, including AL, HI, IL, MA, ME and SC
- **Bonding** – A few states, including AL, MA and ME require the co-venturer to obtain a surety bond



Regulation of Commercial Co-Ventures: State Law

- **Written Contract** –
 - Many states (including NY and NJ) require a written contract, which must be filed with the state by co-venturer
 - Handful of states (including AR, CT, NH and UT) require the charity to file a copy of the contract. Some states require specific terms to be included in contract, including:
 - Identification of charity or charitable purposes benefited
 - Description of sales promotion, including good/services and estimated number to be sold
 - Description of offer to be made to the public regarding amount to be given to charity [N.Y. Exec. Law § 170-b(2)]
 - Terms relating to charity's right to cancel [N.Y. Exec. Law § 174-a]
 - Charity authorization, e.g., MA requires the signatures of 2 officers [Mass. Laws Ch. 68 § 22(a)]
 - Location, start, and end dates of sales promotion
 - Both parties must keep a copy of the contract



Regulation of Commercial Co-Ventures: State Law

- **Advertising Disclosures**
 - Ads must disclose anticipated portion of the sales price, % of the gross proceeds, dollar amount per purchase, or other consideration or benefit received by charity. [N.Y. Exec. Law § 174-c]
 - Some states require disclosure on a per-unit basis
- **Accounting & Recordkeeping**
 - Most states require commercial co-venturers to keep records, provide the charity (and sometimes the state) with a final accounting of the campaign, and keep that accounting for a specified number of years
 - CA: Funds raised must be given to charity every 90 days during campaign [Cal. Gov't Code § 12599.2]



Regulation of Commercial Co-Ventures: State Law

- **Co-venturer obligations** – States generally impose requirements on the commercial co-venturer only
- **Charity obligations** –
 - A few states impose certain CCV requirements (filing of notice, contract, and accounting) on the charity
 - Charities should be registered to solicit funds under charitable solicitation laws in states where sales promotion will run
- Requirements vary by state. Check the statute!
- Most state laws and forms can be found via the National Association of State Charity Officials website:
www.nasconet.org/agencies



Regulation of Commercial Co-Ventures: BBB Standards

- BBB Wise Giving Alliance Standards for Charity Accountability – www.bbb.org/us/charity-standards
- **BBB Standard 19**
 - Should clearly disclose how charity benefits from sales promotion.
 - Ensure that sales promotions **disclose** the following **at the point of solicitation**:
 - the actual or anticipated portion of the purchase price that will benefit the charity (e.g., 5 cents will be contributed to ABC charity for every XYZ company product sold);
 - the duration of the campaign (e.g., the month of October); and
 - any maximum or guaranteed minimum contribution amount (e.g., up to a maximum of \$200,000).



Federal Tax Law and Maximizing CCV Income

- If charity plays a wholly passive role, the funds it receives from the CCV should count as public support
- If charity has a more **active role** and/or provides any **“return benefit”** to co-venturer (e.g., including the co-venturer’s name and logo on charity website in connection with the promotion), then **UBIT may be triggered**
- In that case, structure as a **qualified corporate sponsorship payment**



How to Approach Commercial Co-Ventures

- **Identify CCVs.** Ensure staff is able to recognize a charitable sales promotion and informed about CCV regulations. Consider developing a checklist of issues to address in selecting and working with commercial entities.
- **Advance Planning.** Pick co-venturer wisely—you want them to be established, organized, and serious about compliance. Give yourself and co-venturer plenty of time to meet state requirements—particularly disclosures on ad copy—well in advance of start date.
- **Written Contract.** Required by most regulating states, the written contract should contain any required terms and standard legal protections, and should be signed by charity officer (or two, in MA).
- **Monitor Co-Venturer for Compliance.** Nobody wants a state investigation. It is in the charity's best interests to encourage the co-venturer to meet state requirements and to enforce terms of the CCV contract, both before and after to the start of the promotion.



Contract “Must Haves”

- Clear Tax Treatment & Description of Activities
- Bifurcate Activities With Differing Tax Treatment or Enter Into Separate Agreements
- Indemnity & Insurance
- Branding & Intellectual Property Terms
- Term & Termination
- Reps and Warrants Re: Compliance With Laws
- Advance Approvals
- Conflict of Interest & Confidentiality
- Specific CCV Terms, If Applicable



Joint Activities



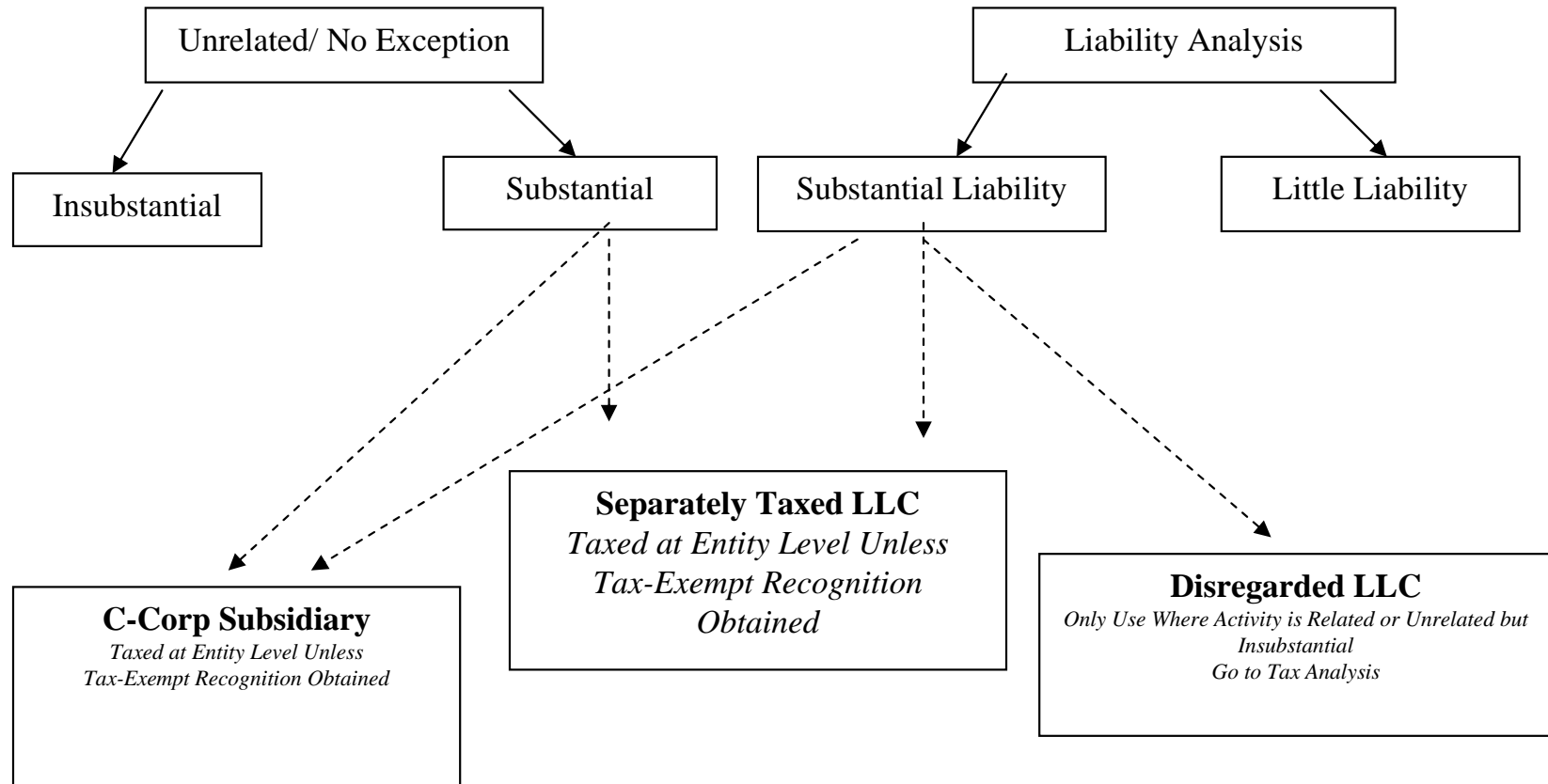
Related Activities Contract Clauses

- Typically Handled Through **Contract** - Exception: Liability Management
 - Educational event fees (including ticket sales)— ALMOST NEVER
 - Educational content – ALMOST NEVER

- **Scope**
- **Exclusivity**
- **Ownership of IP**
- **Allocation of Risks/Indemnification**
 - Financial Losses
 - Legal Claims
 - Can Be **Difficult to Apportion Responsibility** as Contemplated by Typical Indemnity
- **Allocation of Costs**
 - Contracts
 - Financial Contributions
- **Distribution of Profits**



Managing Activities and Program Liabilities



Unrelated Activities

- Furtherance of **Mission**
- Taxability of the income received will **depend on contents of contract, reality of relationship**
- Unrelated Business Income Tax (**UBIT**)
 - It is a **trade or business**,
 - It is **regularly carried on**, and
 - It is **not substantially related** to furthering the exempt purpose of the organization.
- **Examples:**
 - **Advertising** — **ALMOST ALWAYS**
 - **Consumer products unrelated to mission** – **ALMOST ALWAYS**



Tax and Liability Drive Structure

What Is the Nature of the Activity?

Mission & Tax Analysis

Liability Analysis



Taxable Activities, Liability & Attribution

- **Substantiality**
 - Fluid Concept, Generally 15% of Activities or Income
 - **House Unrelated Activities** Without Jeopardizing Tax-Exempt Status

- **Shield from Liability**
 - Financial Liability
 - Vicarious Liability for Claims



Managing Liability Related & Insubstantial Activities

Disregarded LLC

- Single Member, No “Check the Box”
- Shield From Liability (Legal, Not Tax)
- Exempt from Federal Income Tax Under Parent’s Tax-Exempt Determination Letter
- All Activities, Income and Expenses Report on Form 990 – Taxation Dependent on Activity Analysis
- If Activities of Disregarded LLC Are Unrelated and Substantial, Could Jeopardize Tax-Exempt Status



Managing Liability & Taxation

- Separately Taxed LLC
 - Rights and Roles Outlined in Operating Agreement
 - Note Appreciation of Value Issues
- C-Corporation
 - Rights and Roles Outlined in Operating Agreement
 - More Formal
 - Can Issue Stock



Separate LLCs and Corporations

- Can Be Tax-Exempt or For Profit
- Legal - Complete Protection from Legal Liability (Beware of “Mere Instrumentality” and Corporate “Piercing”)
- Tax - Activities Not Attributed to Parent; Important Where Activities Are Unrelated
- Choice Between LLC & C-Corp. Depends on Needs of Entity

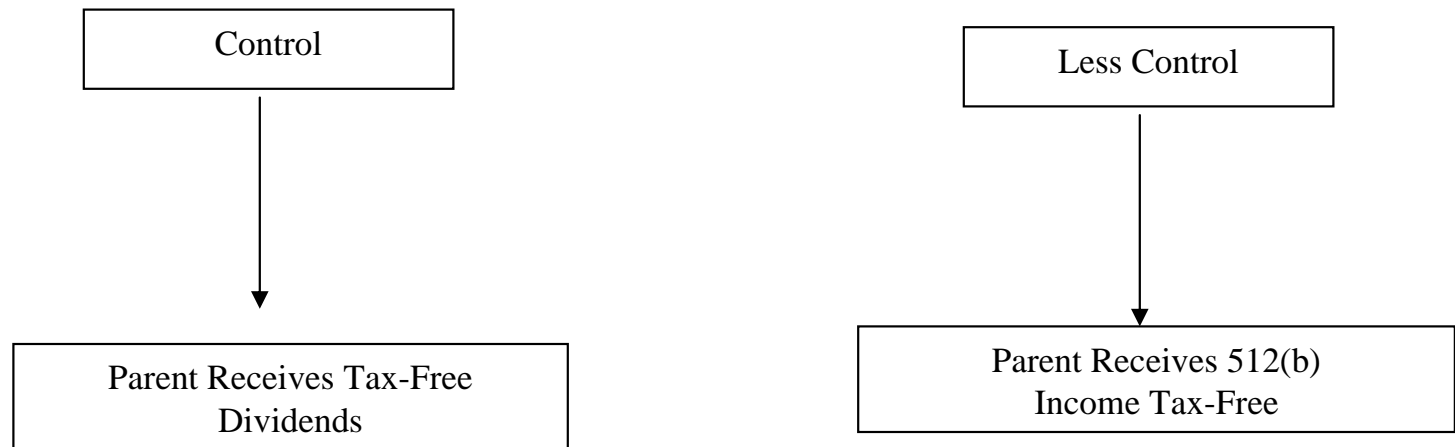


Tax Implications for Separate Entity

- Tax-Exempt Activities Require **Separate Tax-Exempt Determination** to Avoid Taxation
 - But Can **Bifurcate** Activities
- Corporation Is Treated as a **Separate Taxpayer**, Subject to Income Tax at a Maximum Rate of 35%



Tax Implications for Parent Taxable Subsidiaries



Slippery Slope of Control

An Entity Is a Controlled Organization if the Controlling Organization Owns:

- By **Vote or Value More than 50 Percent of a Corporation's Stock** (for an Organization that Is a Corporation) or **Beneficial Interest** (for an Organization that Is an LLC)
- Control of a **Nonstock Corporation Means At Least 50 percent** of the **Directors or Trustees** of Such Organization **Are Either Representatives of, or Directly or Indirectly Controlled by, the Controlling Organization**



Tax Implications for Parent

- If Not Controlled, IRC 512(b) Distributions Will Not Result in UBIT to Parent
 1. Dividends (from Stock)
 2. Interest (Typically from Extended Credit)
 3. Royalties (Intellectual Property License)
 4. Rent (Such as Rented Space)
- But If a Subsidiary Is Controlled, Only Dividends
 - Controlling Organization Must Include the Payment as Unrelated Business Taxable Income (UBTI) to the Extent:
 - Payment Reduces the “Net Unrelated Income” (or Increases the “Net Unrelated Loss”) of the Controlled Entity



Joint Ventures & Tax-Exempt Status

Partnering With Non-Charitable Entities

- “Whole Joint Venture” – Where Nonprofit Contributes Substantially All of Its Assets.
 - 51% or More of Voting Rights – Not Mere Veto
- “Ancillary Joint Venture” – Portion of Resources Are Contributed
 - Control over Tax-Exempt Aspects of the Joint Venture
 - Voting, Ownership Interests and Liability in the Joint Venture that are Consistent with Capital Contributions
 - Joint Venture Gives Priority to the Tax-Exempt’s Purposes over Maximization of Profit for Participants in the Joint Venture
 - Prohibition on Activities That Would Jeopardize the Tax-Exempt Owner’s Tax-Exempt Status



Questions and Discussion

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