

Nonprofit Strategic Partnerships: Building Successful Ones and Avoiding the Legal Traps

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Overview & Introduction



Overview

- **Joint Activities**
 - Joint Programs – By Contract
 - Subsidiary Entities – More Complex
 - LLCs
 - Corporations
- **Promotional and Fundraising Affiliations**
 - Corporate Sponsorships
 - Licensing (Passive Royalty Income)



Need Drives Structure

- Permanence/Up Start
- Desired Flexibility
 - Capitalization
 - Recruiting and Pay
 - Ability to Participate in Joint Ventures
- Type of Activity
 - Liability
 - Tax-Exempt Status



Taxable Activities, Liability & Attribution

- Substantiality

- Tax-Exempt Status at Risk if Non-Exempt Activities Constitute a “Substantial” Part of Exempt Organization’s Activities or Income
- Undefined Concept, Generally 15% of Activities or Income
- House Unrelated Activities in Subsidiary to Avoid Jeopardizing Tax-Exempt Status

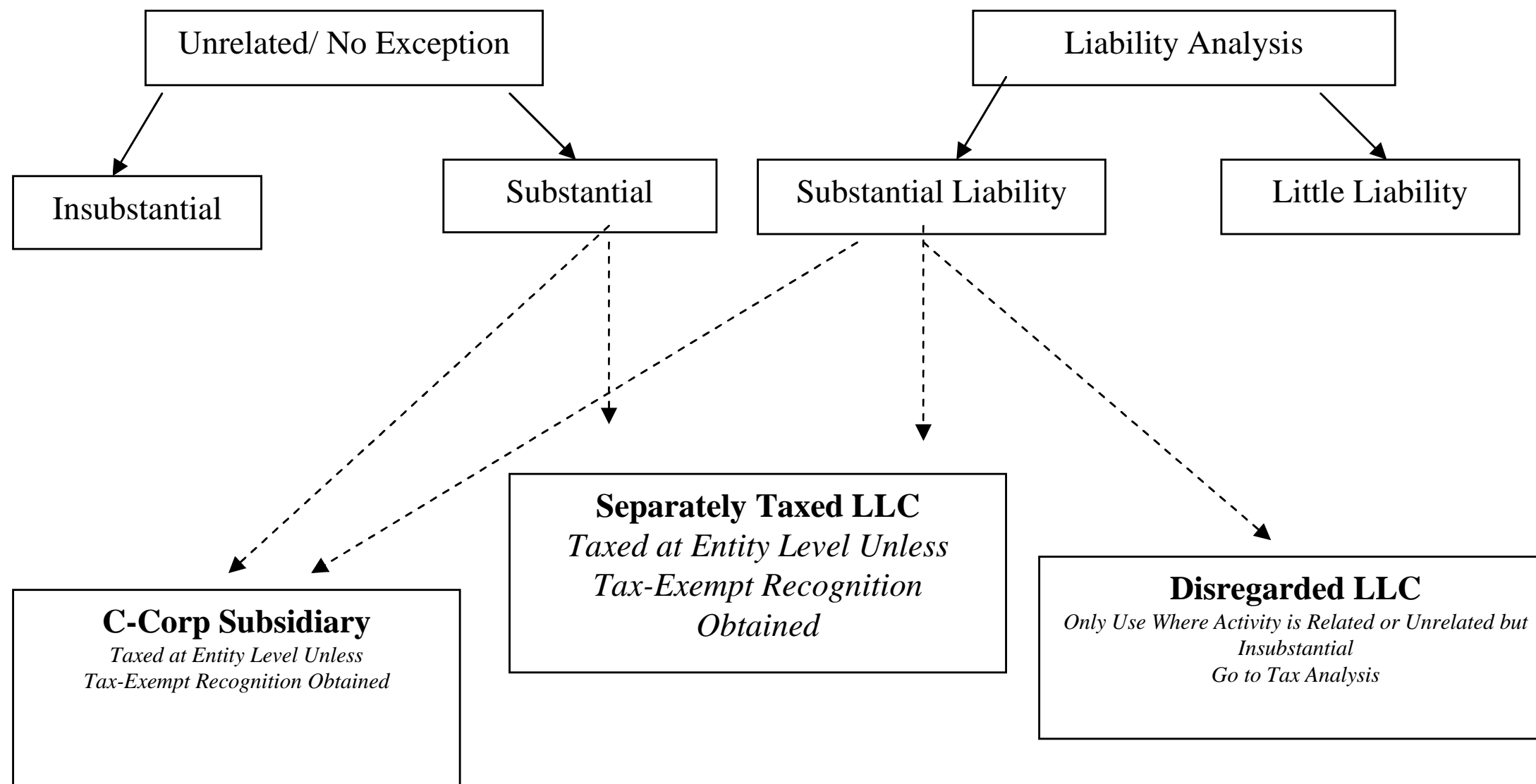


Liability – Tort, Bankruptcy, Etc.

- Shield from Liability
 - Financial Liability
 - Vicarious Liability for Claims
- Insulation of Parent from Potential Liability
- Liability for Legal Claims, Tort Claims
- Bankruptcy, Other Financial Claims
- Shield from Liability



Managing Activities and Program Liabilities



Options



Choosing a Form

- Contract
- Limited Liability Company
 - Disregarded; Separately Taxed
- Corporation
 - For-Profit; Tax-Exempt



Contract Clauses

- Outline Respective Roles, Rights and Obligations of Partnership in Contract
- Should Include the Following Provisions:
 - 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 Liability Related & Insubstantial Activities

Disregarded LLC

- Single Member, Considered Branch or Division of Member for Tax Purposes
- 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
 - Treated as a Corporation for Tax Purposes
 - Activities Not Attributed to Parent
- C-Corporation
 - Rights and Roles Outlined in Operating Agreement
 - More Formal
 - Can Issue Stock



Limited Liability Company

- An LLC Owned by Two or More Entities Can Be Disregarded
 - Exempt Owner Maintains Control
- Exempt Owner Treats Operations and Finances of the LLC as Its Own for Tax Purposes
- If LLC Activities Are Unrelated to the Owner's Exempt Purposes, Could Jeopardize Tax-Exempt Owner's Status
- However, If Advances Tax-exempt Purposes, Can Be Useful for Limiting its Owner's Liability on a Specific Project
- May Qualify for Tax-Exempt Status (See 2001 EO CPE Text Topic B)

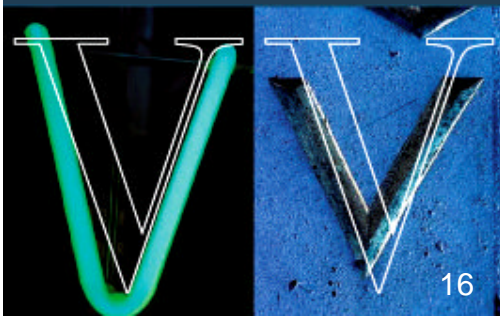


Separate LLCs and Corporations

- Can Be **Tax-Exempt** or **For Profit**
- May Be **Controlled** by Exempt Organization
- **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



Control



Financial Considerations

- **PLRs** – Suggest Limits on Assets which May Be Transferred to a For-Profit Entity
- **Prudent Investor**
 - Director Review
 - Rate of Return



Tax-Exempt Status

- “**Whole Joint Venture**” – Where Nonprofit Contributes Substantially All of Its Assets.
 - 51% of More of Voting Rights and/or Veto Power
- **Ancillary** Joint Venture” – Portion of Resources Are Contributed



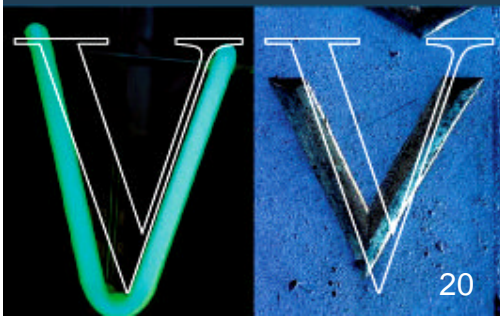
Tax-Exempt Status

- Control over Tax-Exempt Aspects of the Joint Venture
- Voting and Ownership Interests 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

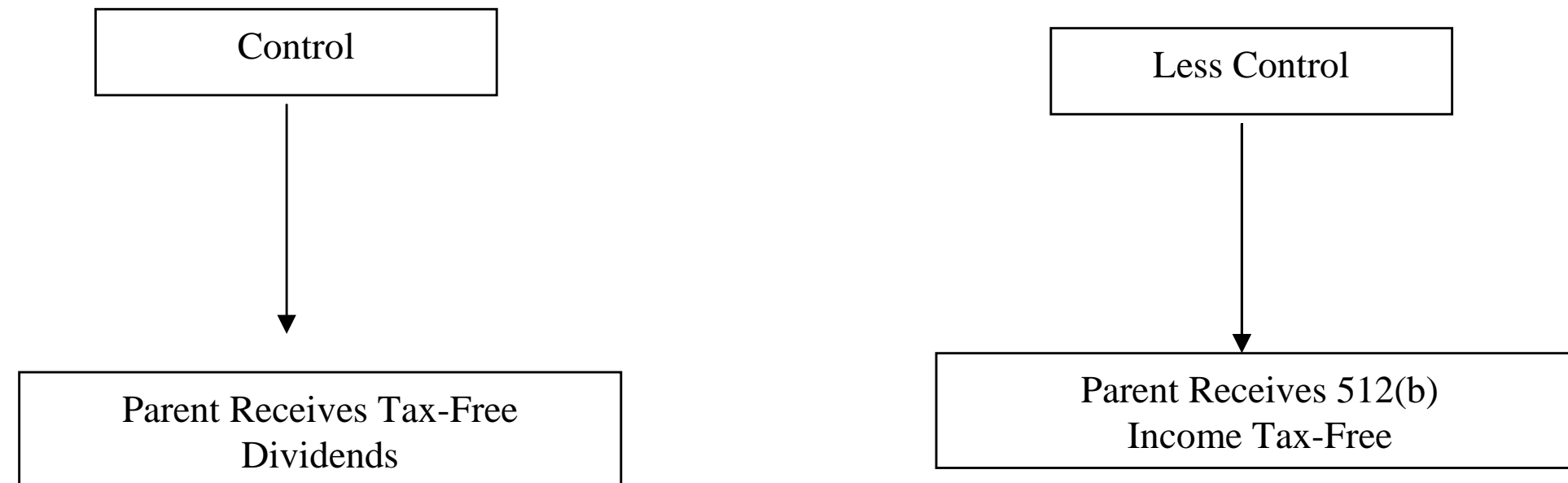


Methods of Control

- Program Guidance
- Voting Rights
- Rights to Appoint Board
- Staffing



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 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 Corporate Income Tax at a Maximum Rate of 35%



Tax Implications for Parent

- If Not Controlled, IRC Section 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, 2-4 (Excluding Dividends) Do Not Apply



Net Unrelated Income Excess Benefits

- Controlling Organization Must Include the Payment as Unrelated Business Taxable Income (UBTI) to the Extent that the Payment **Reduces the “Net Unrelated Income”** (or **Increases the “Net Unrelated Loss”**) of the Controlled Entity
- Also Be Aware of IRC Section **4958 Excess Benefit Application** to Controlled Entities

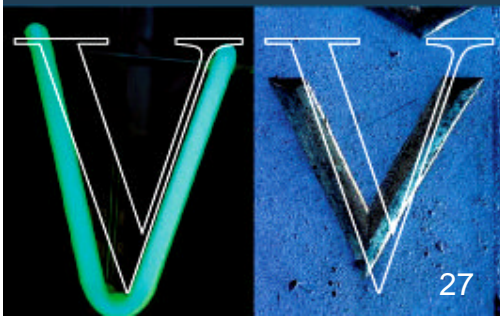


Attribution and Corporate Piercing

- **Separateness**
 - Shared Staffing, but Separate Tracking
 - Financial Separation
- **Corporate Formalities Important**
 - Regular Meetings
 - Documentation



Fundraising and Promotional Affiliations



Corporate Partnerships Maximizing Income

Qualified Sponsorship Payments

- Payment with No Expectation of Substantial Return Benefit
- Disregarded Benefits:
 - 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
- Payments Received for **Advertising** Are Characterized as **UBI**



Licensing Arrangements

- Royalty: Payment for Use of Valuable Intangible Right
- License Name, Mark and Mailing List, and Other Intellectual Property
- No Active Promotion or Services (or Quantify Value and Pay Tax)
 - Announcement Letter Okay
 - Quality Control Measures Okay



Commercial Co-Ventures

- **Commercial Co-Venture (“CCV”)** – 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
- For-Profit Business Uses Name and/or Logo of Charity for Purposes of Increasing Sales of Business’s Products or Services and Increasing Revenue to Charity
- 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 Regulating Various Methods of Fundraising, Including Charitable Solicitations and CCVs
- About 20 States Have Laws Specifically Regulating CCVs
- New York 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]



Regulation of Commercial Co-Ventures: State Law

- State Law Requirements, Generally:
 - *Registration*
 - *Bonding*
 - *Written Contract*
 - *Advertising Disclosures*
 - *Accounting and 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 the CCV.
 - Some States Require Specific Terms Regarding Sales Promotion, Charitable Purposes Benefitted, and Charity's Right to Cancel Be Included in the Contract.
- **Advertising Disclosures** – Advertisements Must Disclose Anticipated Portion of Sales Price, % of Gross Proceeds, or Other Benefit Received by Charity.
- **Accounting & Recordkeeping** – Most States Require CCV to Keep Records, Provide Charity (and Sometimes the State) with Final Accounting of Campaign, and Maintain Accounting for Specified Number of Years.



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.



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 the Sales Promotion
 - Ensure That Sales Promotions **Disclose** the Following **at the Point of Solicitation**:
 - 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);
 - Duration of the campaign; and
 - Any maximum or guaranteed minimum contribution amount (e.g., up to a maximum of \$200,000).



Questions and Discussion

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