Managing Nonprofit Affiliated Entities

Lindsay M. Nathan
Partner | +1 212.218.2137 | lmnathan@Venable.com

Ryan S. Kasdin
Counsel | +1 310.229.9629 | rskasdin@Venable.com

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Agenda

- Creating Affiliated Entities
  - Why Have Affiliated Organizations?
  - Key Considerations and Benefits
  - Key Drawbacks
- Using Affiliated Entities for Advocacy
  - Considerations
  - Comparison of Entities
  - Risks
- Key Questions to Ask Before Forming an Affiliated Organization
  - Potential Alternatives
- Managing Affiliated Entities
  - Maintaining Separateness
    - Governance
    - Finances
    - Branding/Website
    - Resource Sharing
  - Common Questions
    - Rogue Affiliates
    - Choosing the “Main” Entity
    - Sharing Websites

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Creating Affiliated Entities

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Why do nonprofits create affiliated entities?

- Reasons for creating new entities vary, but they are often driven by the intersection of tax-exempt status and business needs

- Types of tax-exempt organizations considered for this presentation:
  - 501(c)(3) – Charitable and educational organizations
  - 501(c)(4) – Social welfare / advocacy organizations
  - 501(c)(6) – Trade associations / business leagues
  - 527 – Political organizations

- Affiliated entities
  - Corporation – tax-exempt or for-profit
  - LLCs – disregarded/pass-through or S-corp

Why do nonprofits create affiliated entities?

- Typical motivations
  - Programmatic expansion
  - Risk containment
  - Revenue generation
  - Other business reasons

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Why do nonprofits create affiliated entities?

Programmatic Expansion – Advocacy

- Political activity/lobbying
  - 501(c)(3) (public charity) – limited lobbying, no political campaign intervention
  - 501(c)(4) / 501(c)(6) – unlimited lobbying, limited political activity
  - 527 (PAC) – unlimited political activity

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Why do nonprofits create affiliated entities?

Programmatic Expansion – Certification

- Professional certification activities
  - IRS views certification as a private benefit and a 501(c)(6) activity
  - Can result in denial / loss of exemption if conducted through 501(c)(3) organization

Why do nonprofits create affiliated entities?

Programmatic Expansion – For-Profit Activities

- For-profit initiatives
  - UBIT - some is OK, but too much can cause loss of exemption
  - For-profit entity can attract investors, talent with equity offerings
  - Easier spinoff / sale if contained in a separate entity

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Why do nonprofits create affiliated entities?

Programmatic Expansion – Branding

- Branding / project identity
  - Create distance from main entity / brand for controversial program
  - Create locally based organizations for political or advocacy purposes

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Why do nonprofits create affiliated entities?

Risk Containment

- Risky asset
  - Real estate

- Risky activity
  - International expansion
  - Youth summer camp

- Tax risk
  - Substantial unrelated activity

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Why do nonprofits create affiliated entities?

Revenue Generation

- Tax-exempt revenue generation
  - Foundation affiliate
  - Supporting organization
  - Engaging new donors

- For-profit activity
  - Greater revenue generation opportunities in for-profit affiliate

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Why do nonprofits create affiliated entities?

Other Business Reasons

- Necessity
  - E.g., foreign entity requires two members but an organization wants to be the sole member
- Protection of assets
  - Creation of supporting organization to fund-raise if main entity faces perils

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What are the drawbacks of having affiliated entities?

- Administrative burden
  - State registration and reporting for each entity
  - Multiple IRS Form 990s or tax reports
  - Separate bank accounts
  - Separate board meetings
  - Manage the sharing of resources between organizations (time tracking, cost tracking)

- Cost
  - Start-up costs
  - Maintenance costs
  - Reporting costs
  - Infrastructure buildout
  - Additional resources

What are the drawbacks of having affiliated entities?

- Mission creep
  - Think about alignment between original / primary entity and affiliated entities
  - Are the affiliated entities serving the mission of the main entity?

- Mission drift / loss of control
  - Different leadership, boards, missions can lead to different priorities over time

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Using Affiliated Entities for Advocacy

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Considerations

- Increased advocacy is one of the primary reasons to create affiliated entities.

- Why do organizations do it?
  - Protect and advance your organization / members / interests / issues
  - New opportunities
  - Lobbying / political activities
  - Enhance reputation
  - Promote favorable regulatory climate
  - Engage with different supporters and donors

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Nonprofit Advocacy – Comparison of Entities

501(c)(3): Public Charity	501(c)(4): Social Welfare 501(c)(6): Trade Association	527 Political Committee
Charitable deduction may be available	No charitable deduction; portion of dues attributable to lobbying not deductible as business expense	No charitable deduction
No "campaign intervention" • No endorsements • No contributions, expenditures, or use of corporate resources • No communications to support candidates or parties • No "biased" communications or activities designed to benefit a candidate or party Can engage in nonpartisan GOTV, debates, voting records and questionnaires	Campaign intervention permitted, but limited • May not be primary purpose • May contribute to candidates (if allowed under state law) • May establish PAC (SSF, super PAC) • May make communications to support candidates (beware of registration and donor disclosure)	Campaign intervention is primary purpose • Used to engage electorally in a way that supports the mission of the organization • Connected (SSF) and Nonconnected PACs; super PACs • Requires registration, disclosure of contributions and expenditures
Lobbying may not be "substantial part" of activities • Unlimited issue advocacy OK as long as not "lobbying"	Unlimited lobbying and issue advocacy	Limited lobbying and issue advocacy is OK • Must have the primary purpose of influencing elections
May establish and share services with 501(c)(4) and 501(c)(6) May NOT support 527	May establish and share services with either 501(c)(3) or 527 organizations	May be established by and share services with 501(c)(4) or 501(c)(6) May NOT be supported by 501(c)(3)

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Potential Risks

- Potential risks include:
  - Loss of tax-exempt status
    - 2020 PLR – entity that used 501(c)(3) resources to support 527 organization owned by for-profit subsidiary could lose its tax-exemption, even where 527 paid fair market value for resources provided by 501(c)(3)
      - Must use caution when sharing services amongst affiliated entities!
- Tax penalties
  - Excess lobbying, tax on political expenditures
- Reputational risk
- Donor or member complaints
- Donor disclosure

Key Questions to Ask Before Forming an Affiliated Organization

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Why do we *think* we need this entity?

- We want to expand our programmatic reach.
- We are a 501(c)(3) and think it's important to the mission to have an entity with an aligned mission that can do more lobbying or engage politically.
- We are a 501(c)(4)/501(c)(6) and we think having a research / educational affiliate will help bolster our mission.
- We have donors / supporters / members who have encouraged us to expand our work.
- We are a 501(c)(4) and we know there are potential donors who would like to support our mission but will only give to public charities.

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Do we actually *need* this entity?

Can we use an existing entity?

- Grantee
- Coalition partner
- Existing affiliate

Does the risk justify the cost?

- Can we manage the administrative burden?
- Do we understand and can we follow the rules for managing affiliates?
- Will our donors, staff, or members be supportive of the new entity?

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Do we need it now?

Do we have sufficient funds to sustain the new organization?

Will administration/support of the new entity detract from our current projects and priorities?

Can we test the new activity to see if it's successful before forming a new affiliate?

Is there another alternative?

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Potential Alternatives – Existing Entities

If you aren't ready to form a new affiliate:

- Use your existing entity
  - Within your nonprofit
    - Test program to see if it can be effectively scaled (assuming activity is consistent with tax-exempt status)
    - Create a DBA
- Work with existing peer organizations with aligned missions
  - Grant-making
  - Coalitions
- Affiliation agreement

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Potential Alternatives – Contracts

- Affiliation agreement
  - More common with chapters / local affiliates and international affiliates
  - Not formally related through governance control

  - Encourage alignment through sticks and carrots
    - Access to funding, infrastructure support, IP licensing, member / donor lists
    - Require adoption of strategic plan, policies; outcome reporting; data sharing
      - Require common language
    - Return of assets, loss of IP rights, indemnification in event of breach

  - Be mindful of applicable law
    - Foreign registration requirements
    - Foreign data / privacy considerations
    - Tax status and terms of funding / asset use

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Managing Affiliated Entities

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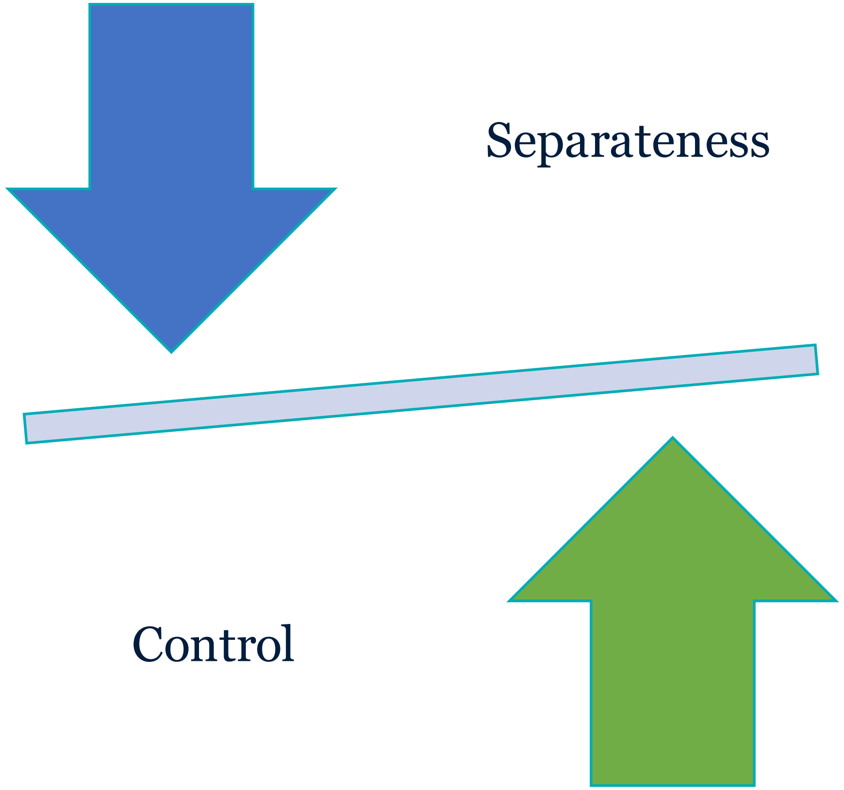
Managing Affiliated Entities – Key Considerations



- Balance Separateness vs. Control
- Ensure affiliates remain aligned in mission
- Protect integrity of each entity's distinct existence and tax status
- Ensure political activities of 501(c)(4)/501(c)(6) are not imputed to 501(c)(3)
- Balance will influence decisions regarding how affiliates are structured and managed

Corporate Issues & Formalities

Corporate Separateness

- Make sure entities are treated as separate, even where there are overlaps
- Provide adequate capitalization of new entity given its goals and operations
- Avoid commingling of assets; maintain separate accounts

Corporate Formalities

- Separate boards and governance
- Separate board meetings and minutes
- Separate policies and contracts
    - Policies should be adopted by each entity
    - Helpful to use same policies for consistency
- Contracts between entities

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Tax Issues

- Tax separateness (preventing attribution of one entity's activities to the other entity)
  - Sharing of assets
    - Arm's-length transaction
    - Documentation / written agreements are important
    - Charitable assets should be provided at fair market value
    - 501(c)(3) does not support political activities
  - Outward representations of the affiliates as a single entity
    - Think about branding, public communications, websites
    - Make sure to use full legal name when required (e.g., fundraising, solicitations, political activities)

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Governance and Leadership Structure

- Control and alignment through governance:
  - Member / manager relationship
    - Appointment of Board, approval of fundamental corporate decisions
    - Operational authority over LLC
  - Board of Directors
    - Appointment authority
    - Overlapping Board
    - *Ex officio* positions on affiliate Board
    - Majority vs. minority overlap; independent Board members
  - Executive leadership overlap

Finances

- Capitalization of new entity
  - Adequately capitalize the new entity; should not be dipping into account of existing entity
  - Basis for capitalization
    - Same tax status, in furtherance of mission
    - Investment in new entity
    - Start-up loan
    - Permitted grant (i.e., from (c)(6) to newly created (c)(3) entity)
- Tax reports and financials
  - Even with combined financials, need to separately track assets for each entity
  - May require separate tax reporting

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Finances

- Separate bank accounts; don’t commingle assets
  - Document any transfer of assets
  - Track start-up costs for reimbursement
- Fundraising
  - Each entity should do its own fundraising (though grants between the entities may be possible)
  - Each entity should also pay its fair share of fundraising, overhead, staff and administrative costs

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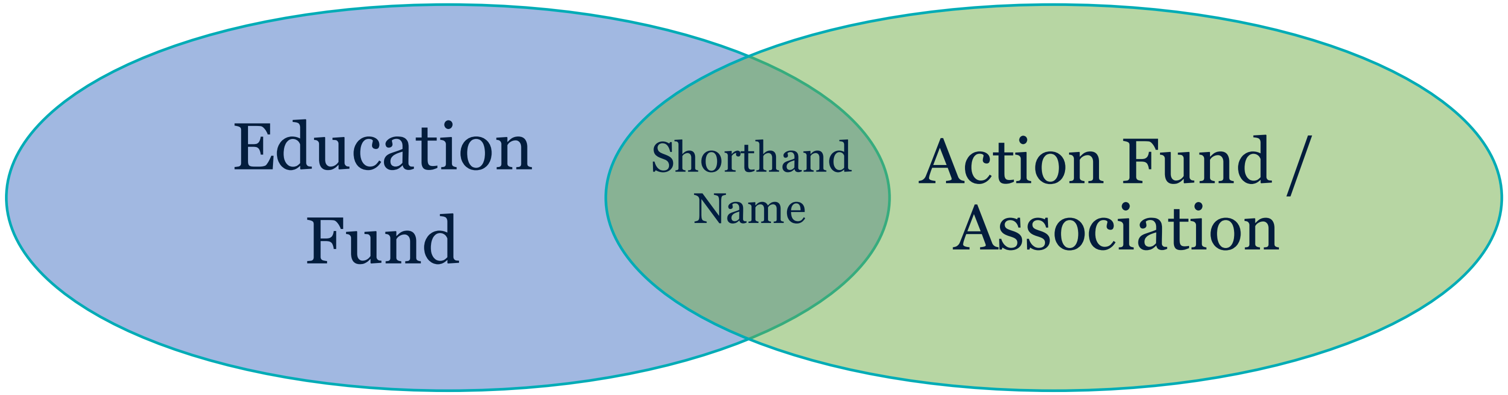
Branding

- Similar branding
  - Must make sure there is distinctiveness in brand IDs for each organization
    - Especially important for fundraising, contracts, lobbying, and political activities
    - Full legal name should be on all solicitation materials
    - Educational Fund vs. Action Fund

  - Single "shorthand" name or shared logo can tie the organizations together
    - Make sure that 501(c)(3) brand is never connected to political activity!



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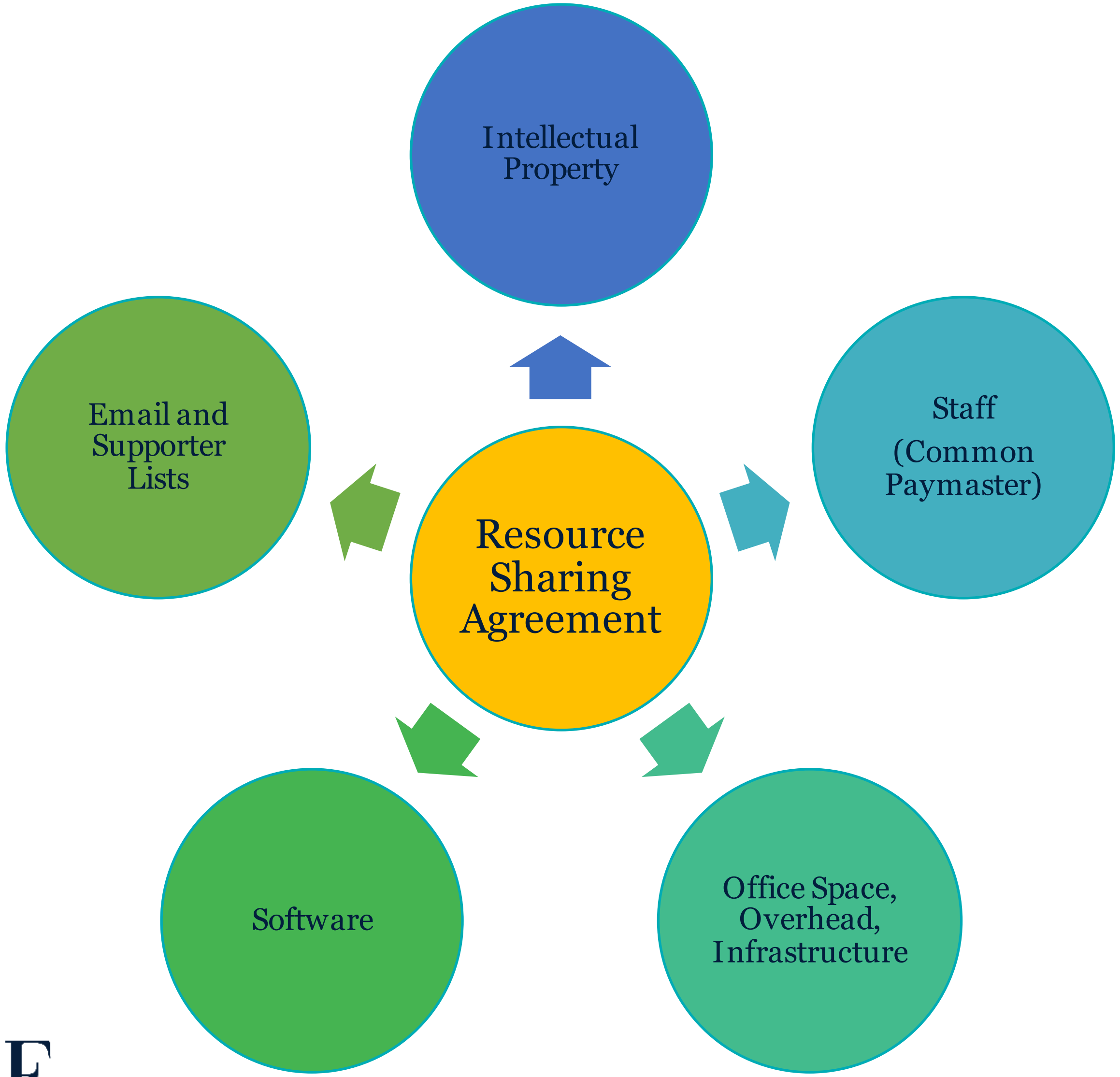
Website

- Separate and distinct!
  - Ideally, separate websites
  - May be able to link to affiliate homepage, but should not link to programmatic content
  - May consider using a pop-up to connect to affiliate page

  - Branding and identification on each page are important
    - Each entity should have distinct URLs and distinct look and feel
    - Be very careful about political messaging in particular
    - Legal notices, design, domain name
    - 501(c)(3) site and brand may not be used in connection with political activity, even through linking
      - E.g., terms of use and privacy policy that reference the 501(c)(3) organization but appear linked on a political page

Resource Sharing



Resource Sharing

- Resource sharing can cause issues including private benefit, inurement, and prohibited political campaign intervention, in addition to general corporate separateness issues

- Shared services agreement is essential
  - Demonstrates separate corporate identity
  - Sets terms of resource sharing
  - Addresses risk allocation

- Negotiation and Approval
  - Independent Board members should approve on behalf of each entity
  - Different signatories

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Resource Sharing Agreement

Resources to be Shared	Financial Terms	Key Legal Provisions
• Staff • Overhead • IP License • Email List	• Which entity is providing resources? • Value of services (fair market value or discount) • Pass-through costs (where appropriate; e.g., postage) • Pro rata allocation formulas (e.g., overhead) • Timekeeping procedure • Timing for reconciliation and payment by each entity	• Indemnification • Renewal and Revision Obligations • Termination

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Resource Sharing Agreement

- Implementation
  - Know what the agreement says and follow it
  - Maintain clear records
  - Regularly audit and reconcile records and payments

- Training
  - Periodic trainings with staff
    - Structural overview
    - Programmatic/funding limitations
    - Timekeeping and record keeping procedures

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Common Questions

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Common Questions – Rogue Affiliates

Our affiliate has gone rogue! It's moving in a different direction, using different tactics, and enacting different priorities. It's not communicating with us, and it doesn't think it owes us any response. What can we do?

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Common Questions – Rogue Affiliates

- Legally: it depends on the protections already in place
- Practically: it's often a matter of discussion

- Does your entity have governance rights?
  - Remove (or threaten to remove) directors or executive leadership
  - Membership or shareholder rights

- Does your entity have contractual rights?
  - Terminate (or threaten) IP rights, disaffiliation
  - Revoke (or threaten) funding

Common Questions – Rogue Affiliates

- Appeal to mutual concerns
  - Fidelity to mission, governing documents, and tax status (e.g., supporting organization)
  - Reputational and PR concerns
  - Donor satisfaction

- Incentivize alignment
  - Additional funding opportunities
  - Greater access to resources
  - New opportunities for affiliate input (e.g., leadership council)
  - Get something in exchange
    - Bylaws change
    - Renegotiation of affiliation or services agreement

Common Questions – How do we choose the "main" entity?

We want to have several affiliated entities. Which one should be the "main" entity? Which one should hold the office lease and hire the employees?

Common Questions – How do we choose the "main" entity?

- Do you have an existing entity?
- What are your priorities?
- Risk of activities being attributed to c3 organization
  - Are the programs and funding distinct?
  - Is branding distinct?
  - Is there independence?
  - A PAC should never be created by or use c3 resources
- Is there an obvious main entity from a programmatic and funding perspective?
- Are there different state/local tax benefits for one entity holding the lease over the other?
- Should a separate LLC or other entity hold the employees and resources? Can contribute to independence and separation between the operating entities.

Common Questions – Can’t they share a website?

We already have a website for our charity. Can’t we just create a subpage on the website for our new affiliated entities?

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Common Questions – Can’t they share a website?

- Do the entities share the same tax-status? Mission?
- What content is being displayed on the subpage?

- What’s the risk if one entity’s content is mistaken as the other entity’s content?
  - An “advocacy” extension on charity’s website is still part of charity’s website
  - Identifying the 501(c)(4) organization or PAC name at the top of the page won’t save it
  - Indicia of (c)(3) website likely remain behind (donate button, terms of use)

- Ideally, have separate websites and separate domain names
- If linking between sites, make it abundantly clear that the sites are different
  - Branding differentiation (name, color, logo)
  - Pop-up notice
  - Don’t link directly to political content or PAC website

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