# Family Matters—Managing Risks With Different Entities Under One Umbrella

**Lisa M. Hix, Esq.,** Executive Vice President and General Counsel
American College of Cardiology

**George E. Constantine, III, Esq.,** Partner
Venable LLP

**Ryan S. Kasdin, Esq.,** Counsel
Venable LLP

VENABLE LLP

ACC Association of Corporate Counsel
NATIONAL CAPITAL REGION

# Agenda

1. Affiliated Entities – Why and Why Not
   - Why Have Affiliated Organizations
   - Key Considerations and Benefits
   - Key Drawbacks

2. Creating Affiliated Entities
   - Potential Alternatives
   - Structuring New Entities

3. Using Affiliated Entities for Advocacy
   - Key Considerations
   - Comparison of Entities
   - Risks

4. Managing Related/Affiliated Entities
   - Maintaining Separateness
     - Governance
     - Finances
     - Branding
     - Resource Sharing

5. Common Questions

VENABLE LLP

# Affiliated Entities – Why and Why Not

VENABLE LLP

# Affiliated Entities

- Reasons for creating new entities varies, 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

- Other types of affiliated entities considered
  - Corporation – tax-exempt or for-profit
  - LLCs – disregarded/pass-through or treated as corporation

# Why do nonprofits create affiliated entities, and why might they not

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

- Challenges
  - Administrative burden
  - Cost
  - Mission creep
  - Mission drift / loss of control

VENABLE LLP

# Programmatic Expansion

# Programmatic expansion

- Political activity/lobbying
  - 501(c)(3) (public charity) – limited lobbying, no political campaign intervention
    - *See* 26 C.F.R. § 1.501(c)(3)-1(c)(3)(ii).
  - 501(c)(4) / 501(c)(6) – unlimited lobbying, limited political activity
  - 527 (PAC) – unlimited political activity

- Professional certification activities
  - IRS views certification as a private benefit, generally not a 501(c)(3) activity
    - *See* Tech. Adv. Memo 199912035 (Dec. 17, 1998).
  - Can result in denial/loss of exemption if a substantial activity and conducted through 501(c)(3) organization
  - Section 501(c)(6) is usually the more natural home for certification activities
  - Also note third-party accrediting bodies often like to see separation between certification and other organization activities

# Programmatic expansion

- For-profit initiatives
  - 501(c)(3) organizations – some UBIT 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
- Branding / project identity
  - Create distance from main entity/brand for controversial program
  - Create locally based organizations for political or advocacy purposes
- Acquiring affiliated entities
  - Programmatic synergies
  - Growth

VENABLE LLP

# Risk containment

- Risky asset
  - Real estate

- Risky activity
  - International expansion
  - Youth summer camp

- Tax risk
  - Substantial unrelated activity

VENABLE LLP

# Revenue generation

- Tax-exempt revenue generation
  - Establishing a 501(c)(3) foundation affiliate to a 501(c)(4) or 501(c)(6)
  - Supporting organization
  - Engaging new donors

- Support of international affiliate

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

# Other business reasons

- Legal necessity
  - E.g., foreign entity requires two members but an organization wants to be the sole member
- Long-term preservation
  - Creation of supporting organization to fundraise if main entity facing perils

VENABLE LLP

# What are the drawbacks of having affiliated entities

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

- 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

# Using Affiliated Entities for Advocacy

VENABLE LLP

# Nonprofit Advocacy – Key Considerations

- Increased advocacy is one of the primary reasons to create affiliated entities.
  - *See* Judith E. Kindell & John Francis Reilly, Lobbying Issues, Exempt Organizations Continuing Professional Education Technical Instruction Program FY1997 (July 1996).

- Why do organizations do it?
  - Protect and advance your organization/members/interests/issues
  - New opportunities
  - Enhance reputation
  - Engage with different supporters and donors

VENABLE LLP

# Nonprofit Advocacy – Comparison of Entity Types

| 501(c)(3): Public Charity | 501(c)(6): Trade Association<br>501(c)(4): Social Welfare | 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"<br>• No endorsements<br>• No contributions, expenditures, or use of corporate resources<br>• No communications to support candidates or parties<br>• No "biased" communications or activities designed to benefit a candidate or party<br><br>Can engage in nonpartisan GOTV, debates, voting records and questionnaires | Campaign intervention permitted, but limited<br>• May not be primary purpose<br>• May contribute to candidates (if allowed under state law)<br>• May establish PAC (SSF, super PAC)<br>• May make communications to support candidates (beware of registration and donor disclosure) | Campaign intervention is primary purpose<br>• Used to engage electorally in a way that supports the mission of the organization<br>• Connected (SSF) & Nonconnected PACs; Super PACs<br>• Requires registration, disclosure of contributions and expenditures |
| Lobbying may not be "substantial part" of activities<br>• Unlimited issue advocacy ok as long as not "lobbying" | Unlimited lobbying & issue advocacy | Limited lobbying & issue advocacy is ok<br>• Must have the primary purpose of influencing elections |
| May establish and share services with 501(c)(4) and 501(c)(6)<br><br>Should NOT establish or share resources or services with 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)<br><br>Should NOT share services or resources with 501(c)(3) |

# Nonprofit Advocacy – 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!
      - *See* I.R.S. Priv. Ltr. Rul. 202005020 (Jan. 31, 2020).
  - Tax Penalties
    - Excess lobbying, tax on political expenditures
  - Reputational Risk
  - Donor or member complaints
  - Donor Disclosure

VENABLE LLP

# Creating affiliated entities

VENABLE LLP

# Creating affiliated entities

- Key Questions to Get Started
  1. What's the goal?
  2. Is a new entity actually needed?
  3. If so, what should it look like?

- Ask yourself
  1. Why do we *think* we need a new entity
  2. Do we actually *need* this entity?
  3. Is now the right time?

# 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 on 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.

VENABLE LLP

# 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 the rules for managing affiliates?
- Will our donors, staff, or members be supportive of the new entity?

VENABLE LLP

# Is now the right time?

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?

# 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
  - Grantmaking
  - Coalitions
- Contractual relationship / affiliation agreement

# Potential Alternatives - Contracts

- Contractual relationship / 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

# Structuring the new entity

# Forming the entity

- Limited Liability Company:
  - Asset protection
  - “Related” but risky program expansion
  - For-profit initiatives (taxed as corporation)

- Corporation:
  - Greater independence
  - Different tax-exempt status
  - New organization vs. new initiative

VENABLE LLP

# 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 v. minority overlap; independent board members
  - Executive Leadership

VENABLE LLP

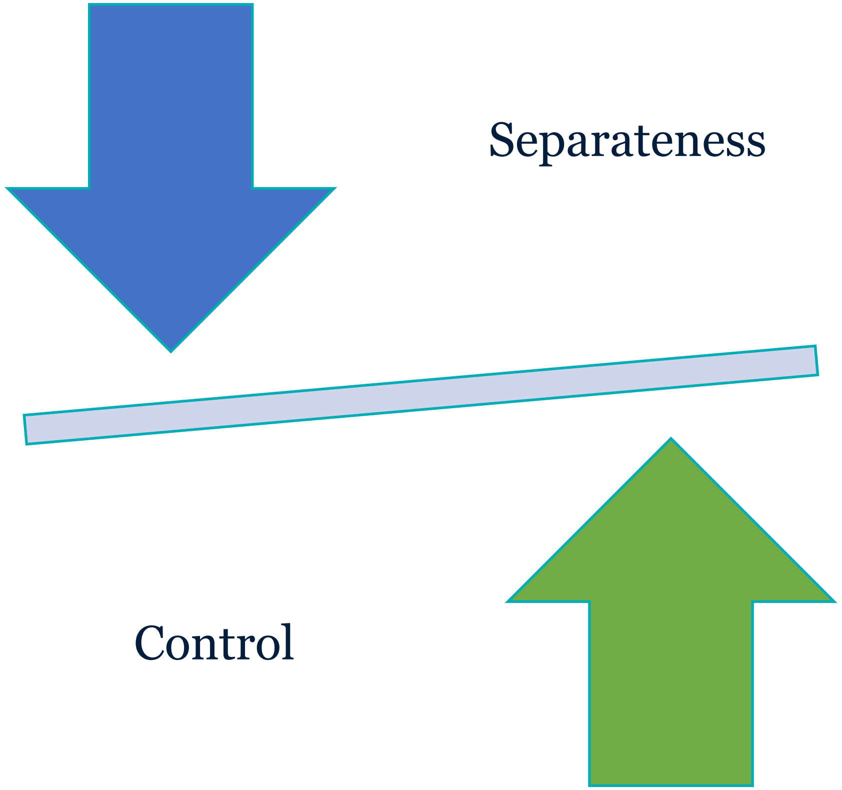
# Funding the entity

- 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 (e.g., from 501(c)(6) to newly created 501(c)(3) entity)

# Managing Affiliated Entities

VENABLE LLP

# 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

- Provide adequate capitalization of new entity given its goals and operations
- Avoid commingling of assets; maintain separate accounts
- *See* Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943); Britt v. United States, 431 F.2d 227 (5th Cir. 1970); and Krivo Indus. Supply Co. v. National Distillers & Chem. Corp., 483 F.2d 1098 (5th Cir. 1973).

## 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

VENABLE LLP

# Tax Issues

- Tax Separateness (or avoiding attribution of one entity's activities to the other entity)
  - Sharing of assets
    - Arms-length transaction
    - Documentation/written agreements are important
    - Charitable assets should be provided at fair market value
  - Outward representations of the affiliates as a single entity
    - Think about branding, public communications, websites

# Finances

- See prior slide regarding capitalization—ensure adequate capitalization, etc.

- Separate bank accounts; don't commingle assets
  - Document any transfer of assets
  - Track startup costs for reimbursement

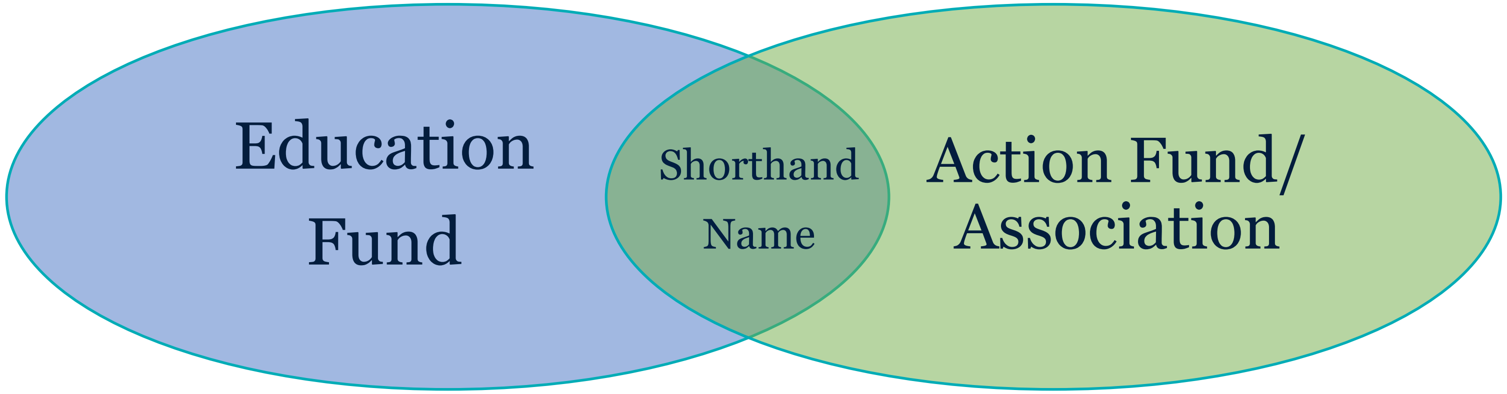
- Fundraising
  - Each entity should do its own fundraising (though grants between the entities may be possible)
  - Each entity should also pay its fair share of fundraising, overhead, staff and administrative costs

- *See* Instructions for Form 990 Return of Organization Exempt From Income Tax, Cat. No. 11283J (Dec 7, 2022) (definition of "Related Organization" in Glossary); 2022 Instructions for Schedule R (Form 990), Cat No. 51519M (Jul. 13, 2022).

# 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!




VENABLE LLP

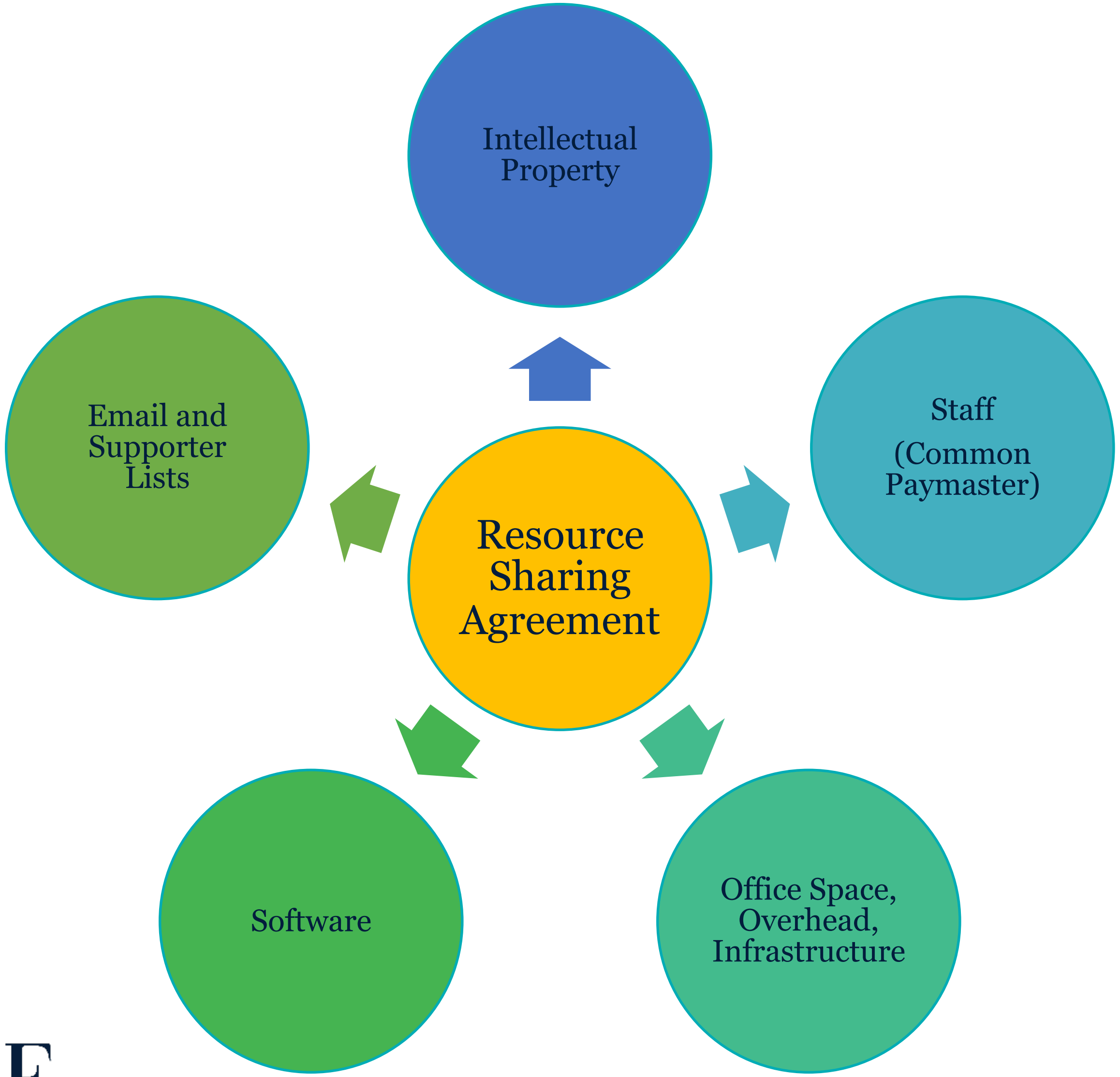
# Website

- 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 popup to connect to affiliate page

  - Branding and identification on each page is 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

VENABLE LLP

# Resource Sharing




VENABLE LLP

# Resource Sharing

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

- Recordkeeping, including time records is important

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

# Resource Sharing

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

VENABLE LLP

# Resource Sharing

- Approval and signature
  - Independent board members should approve on behalf of each entity
  - Different signatories

- Revisit periodically to ensure terms are still appropriate

- Need to do what you say you're going to do, frequently audit/reconcile records and payments and have the ability to implement and enforce the agreement!



# Common Questions

VENABLE LLP

# Common Questions – Can the entities 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?*

- Maybe!
  - 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 c3 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

# Common Questions - Rogue Affiliates

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

- 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

VENABLE LLP

# Common Questions - Rogue Affiliates (continued)

- 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

VENABLE LLP