

Webcast: Nonprofit Organization Affiliates

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Presented by ACC's Nonprofit Organizations Committee and committee sponsor, [Pillsbury Winthrop Shaw Pittman](#)

Moderator: Steven Garrett, Associate Vice President & General Counsel, Texas A&M Research Foundation

ASSOCIATION OF CORPORATE COUNSEL

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September 26, 2006
11:00 a.m. CT

Operator: Just a reminder, today's conference is being recorded.

Female: Steve, please go ahead.

Steve Garrett: Welcome to the Association of Corporate Counsel Nonprofit Organizations Committee Webcast entitled, 'Nonprofit Organization Affiliates'.

My name is Steve Garrett and I'll be the moderator for today's presentation. I am the Associate Vice President and General Counsel for the Texas A&M Research Foundation. I also serve as the Chair of the Webcast Subcommittee of the Nonprofit Organizations Committee of ACC.

Our panelist today is Jefferson C. Glassie, a partner in the Nonprofit Organizations Group of the law firm, Pillsbury Winthrop Shaw Pittman, a firm that is the sponsor of the ACC

Nonprofit Organizations Committee. Mr. Glassie is located in the firm's Washington, DC office where he focuses on a wide range of legal matters for nonprofit organizations including antitrust, tax, certification, accreditation, contracts, employment, merger, intellectual property and corporate issues.

Mr. Glassie has concentrated in the field of nonprofit membership organizations for 30 years. He has significant experience in international legal issues and is the author of "International Legal Issues for Nonprofit Organizations", published by the American Society for Association Executives. He is also Co-Author with Jerry Jacobs of "Certification and Accreditation Law Handbook, Second Edition". Mr. Glassie is the former Chair of the Legal Section Counsel of ASAE and Annual Legal Symposium.

This Webcast is being presented through ACC's updated Webcast page. Attendees may post questions to Mr. Glassie by using the chat function on your screen. You enter a question in the box that's marked, questions, at any time. Just enter in your text in the lower-left box and click, Send.

Your question will not appear on other attendees' screens but will be visible to Mr. Glassie and myself. We may not be able to take your questions during the presentation but we'll try to answer them at the end if there is time. If we don't get to them we'll try to e-mail responses to any questions.

Note that Pillsbury is also planning to issue an info pack to provide resources on the topics included in this presentation, which is expected this fall. And if a question occurs to you

after the close of the presentation you can send it to Mr. Glassie at
jeff.glassie@pillsburylaw.com.

This Webcast is being recorded. The audio file for this Webcast will be available for replay on the ACC Web site about three hours after the end of the presentation and it will be archived on the ACC Web site for about a year. And during the course of this Webcast you can see a Webcast evaluation form on your screen. And please select date and session from the dropdown box. Please take a moment or two to respond to the survey. It is a very useful tool for ACC to organize and present Webcasts for interesting and informative to ACC members.

And now let me turn the presentation over to Mr. Glassie.

Jefferson Glassie: Thank you very much Steve. Hi, everyone. This is Jeff Glassie. Thanks very much for the nice introduction.

And this Webcast is actually one that is sort of unique in my experience. Many, many of our clients and nonprofit organizations are structuring themselves with a number of affiliated organizations and with the help of other corporate organizations and complex structures have become very common. There's not a whole lot in writing on this. So, as Steve mentioned, we do plan to have an info pack with resources that we can pull together for you some time this fall.

This Webcast will be primarily an overview of some of the major issues that we see come up in our practice so that, hopefully, will be helpful to you in your practice as well.

Just so we kind of have an idea of the universe that we're talking about here, we're talking about nonprofit organizations that most of which are nonstock and may be membership associations or charitable organizations, usually tax exempt under either 501c3 is a charitable organization, scientific or education organization or Section 501c4 is a civic league or a social welfare organization or a membership organization under 501c6, trade association of professional society. Of course many 501c3s are also membership organizations.

But, as I say, we see more and more complex structures so that nonprofit, tax-exempt organizations can maximize their legal compliance efforts, their risk management and the efficiencies that effectiveness with which they conduct their operations.

So what we're going to talk about today, this is kind of a quick overview, a wide range of affiliates and issues. We'll talk a little bit about the main organization, including divisions, committees, task forces, et cetera, and how they're structured. Supporting organizations, as well. One of the key affiliates that nonprofit organizations utilize in order to maximize their activities and operations. For-profit subsidiaries, which many nonprofit organizations have or are thinking of setting up to take advantage of some marketing or other business related activities that may not be appropriate or just for risk-management purposes, may want to carve that into a separate organization. Political action committees, which are really another affiliate; another arm or tool of the nonprofit organization, depending on its mission. Other allied organizations, kind of loosely affiliated other nonprofit groups. Affiliates chapters which may be on the local, or state or regional level. International affiliates. And then, a number of different corporate relations, ways that nonprofit

organizations are able to maximize revenues, work with industry partners and others to fulfill the mission. And then some business forms that have become more common for nonprofit organizations as they move ahead, again, to increase their efficiency and activities in the nonprofit world.

So now we will move on here to the next slide, which is just a brief discussion of the main – or we often call it parent organization. I assume that for most of you on the call, this would be the organization that you work for. It could be an unincorporated association. That's probably pretty unlikely these days. When I first started practicing we saw more unincorporated associations but now most nonprofit organizations are corporations formed under the laws of one state or another, usually nonstock. The states refer to them in different ways. Some nonprofit, some not-for-profit, some as nonstock. I would sort of submit that, maybe some technical differences aside, that it's pretty much the same type of organization, not having stock and having a nonprofit purpose under state law.

Usually these parent organizations that we're talking about are tax-exempt, as I mentioned; 501c3, 501c6 or 501c4. C3s, as probably most of you know, are charitable, scientific, educational organizations; have to be exclusively dedicated to c3 purposes; can receive tax-deductible charitable contributions. 501c4 organizations are social welfare organizations. Probably one of the largest nonprofits in the country, AARP, is a 501c4 but also does have a complex structure. And then, 501c6, trade associations, professional societies. And the key to the structure is really laid out in the Articles of Incorporation with the purpose clause, et cetera, as well as the by-laws which form sort of a contract between the organization and its board and members.

Policies and procedures that are adopted by the parent organization also are really key in determining how the organization operates; from conflict of interest policies or financial policies, policies how funds are treated, endowments are treated, et cetera are part of the sort of law of the organization.

Now many nonprofit organizations have subgroups which are within the corporate shell of the organization and are not separately incorporated. They could be divisions, sections, task forces. I should have added committees on there. I don't know what I was thinking. But committees are the same type of an entity. Subgroups or other parts of components of the parent organization that are not outside the organization's corporate structure.

But then there can also be – many organizations have affiliates or chapters on different levels. And since they would typically be separate organizations. Usually there are some kind of contractual relationship with the affiliates or chapters. And usually the affiliates or chapters are referenced in the organization's by-laws.

Now, as I indicated, many organizations, now days, are spinning off subsidiaries for a number of reasons; tax, to protect the tax status of the organization or to put certain activities that are appropriate to one tax status into another organization as opposed to, perhaps, a parent tax status.

Also for lobbying are political reasons particularly setting up political action committee because 501c3 organizations, in particular, are completely banned from conducting political campaign activities and, therefore, setting up a political action committee.

And also for liability reasons. Some activities are considered to be very – or are considered to be more risky than the typical activity of the organization and the Board may feel that it should simply be spun off into another organization. As I mentioned, organizations such as this have numerous alliances that could be for a number of different purposes and we're going to talk about that a little bit more.

Now, supporting organizations -- that's a technical term. As many of you, I am sure know, under the Internal Revenue code, a 509a3 supporting organization, that's typically a 501c3 that supports either a 501c6 or a 501c4 or even a 501c3.

I also could call supporting organizations, subsidiaries. We'll talk, in a minute, about for-profit or stock corporation subsidiaries where the parent owns all the stock of the subsidiary. But a nonprofit subsidiary doesn't have stock but really is controlled by virtue of the -- generally speaking, perhaps a number of ways, but generally speaking, by appointment power over a majority all of the Board of Directors of the supporting organization.

Usually the supporting organizations have no members in our experience unless the supporting organization is not a 501c3, but is, more or less, some other kind of a subsidiary that may be set up so that a pack can be run, or conducted. But it's usually no members. We'll get a little bit -- as I say, a little bit more into the pack and some of the other things, later.

Usually the supporting organization will conduct charitable educational research activities. If a majority, or all of the Board is appointed by the parent organization, that's kind of a rule of thumb that will grant, 509a3, public charity status. As many of you know, 501c3s are

divided into two types; private foundations and public-supported organizations. The fact that a public charity, or an association foundation may be referred to as a foundation doesn't mean that it's a private foundation.

All 501c3 organizations have to be put in one of those two categories. And usually there's, after an advance ruling period, after tax determination is obtained, the IRS will look at the revenues and expenses and the public support of the 501c3 organization and make a determination whether it's actually a public charity or a private foundation which have more strict and onerous sort of rules; distribution requirements, et cetera. Many of you may work for a private foundation. But you don't have to go through that advance ruling period and the five-year determination if you set up a 501c3.

Under 509a3, it kind of grants automatic public charity status, basically, on the fact that the tax-exempt organization that is supported is publicly supported.

Now it's most often the case that supporting organizations, nonprofit, subsidiaries are staffed by the parent. The employees of the parent will typically be sort of given another hat to wear; leased, perhaps, was maybe one way to look at it, to the supporting organization. Management fees and management services, generally speaking, by a tax-exempt organization are not related -- considered related by the IRS. And management fees can be taxed as unrelated business income. There are some rulings that provide that affiliate -- management of affiliates with the same central purposes should not be considered here but we often just sort of avoid -- when we pay for the relationship between the parent and the supporting organization, we try to avoid the word, management, and we've used primarily what are

referred to as cautionary agreements to share staff facilities the cost of copies, et cetera and haven't had too much problem with that.

Of course, as I mentioned, 501c3e organizations can receive tax-deductible charitable contributions which is certainly one reason that a 501c4 or 501c6 may want to set up a 501c3 as to attract tax-deductible charitable contributions for research or other charitable purposes.

And as I mentioned, non-501c3 subsidiaries -- since professional certification, for example, is not considered by the IRS to be a public-purpose 501c3 activity and may only be conducted in a (diminimus) amount by a parent 501c3, certification may be one reason that a non-501c3 organization may be established.

Now we'll talk a little bit about for-profit subsidiaries. As I mentioned, these would typically be general stock corporations established under the law of whatever state, usually the state the organization is doing business in. Many organizations are not incorporated in the same state where they do business. Usually it stays that way because the IRS says if you want to reincorporate you have to get a new tax exemption determination. So rather than risk that and go through that, it's pretty common for nonprofit organizations to just remain incorporated in the state they were incorporated, even though they may have moved their offices to another state. But if they're in a state, it's often most convenient to avoid duplicate of filing fees, et cetera, to establish in the state where the organization has its offices.

The way that we've done it, typically, is have the parent organization be the sole stockholder. You might have a hundred authorized shares, or a thousand authorized shares and the parent would obtain all those shares.

It can be created for a number of reasons. One, minimize tax exemption risk to the parent. If the activity is marketing or some other insurance or some other business activity that could result in unrelated business income to the parent organization. There could also be liability risks for some types of activities, maybe environmental testing or, you know, some activity that the Board of the parent felt was not appropriate and they didn't want to risk the assets of the parent 501c3 or 501c6 organization, for example.

One of the key things, of course, is to not have -- give grounds for anyone to pierce the corporate veil in setting up these types of subsidiaries so you do want to paper the relationship; make sure that the stock is validly issued; that the Board of the subsidiary holds meetings; that there are minutes; all that. In my experience, it's actually not that likely that a nonprofit organization subsidiary would be -- that the separate -- that that corporate ness would be found to be invalidated unless there's some kind of egregious, almost fraudulent or wrongful effort to avoid responsibility. But it's still, obviously, advisable with any of these subsidiaries, nonprofit, for-profit or any affiliates to have something in writing that papers the transaction and to make sure that separate accounts, what-have-you are also undertaken.

I guess the next bullet sort of goes along the lines of the third one. If there are unrelated activities, that would be one reason to set up a for-profit subsidiary. Just as with the nonprofit organizations, the for-profit organizations are often staffed by the parent

organization with the same issue about management fees. But if they are large enough, the parent may have its own employees. I mean, usually the employees are all under one organization because that simplifies benefits programs. You only need to have one employee handbook, one set of policies, et cetera. That's typically the way that we have seen it done.

There's one issue that comes up for for-profit subsidiaries and that is the transfer of funds from the subsidiary to the parent. Section of the code 512b13 provides that dividends are not taxable to the parent because they're already taxable. But if it's a controlled subsidiary, 50 percent or more of the stock or other control, royalties, interest and rents are taxable to the parent. There is a provision in the new law passed by Congress over the summer that limits that to -- it says that if there's a fair-market value of those amounts, for example rent, or if the amount received is not more than the fair market value that they won't be -- those amounts won't be considered as unrelated business income and taxable to the parent. But that's just for a trial period. It makes a lot of sense to me but we'll see what happens there.

The next thing I wanted to talk about a little bit, and many of you may not have as part of your purpose, influencing the political agenda. But certainly many membership organizations do have that as part of their agenda and more c3s, I believe, are finding that it's useful to be able to become engaged in the political arena. Now, it's a problem for c3s because, as I mentioned, 501c3s are absolutely prohibited -- there's a zero tolerance, pretty much a zero tolerance determination made on any political campaign activities. I don't mean just political in terms of lobbying. Of course 501c3s can conduct an insubstantial amount of lobbying and many do elect under 501h, but political campaign activity is a separate matter.

That's obviously regulated under the Federal Election Campaign Act and the Federal Election Commission. The political action committee is ((inaudible)) under the law as a separate segregated fund. Usually they're connected to 501c6 or 501c4 organizations within the FCC rules. One of the key things about a connected (pack) as opposed to a non-connected (pack) is that a connected (pack), it's administrative and management fees and expenses, basically, all of its expenses can be paid by the parent organization which is a tremendous aspect of this because then all of the monies that are received as campaign contributions can actually be then given out as campaign contributions. In other words, all the money that's received by the donors to the (pack) can be kept segregated and given to legislators and those running for office without having to use those funds for administrative and management-type costs. So that's why we usually see connected packs.

It's also very important with a connected pack, though, to be able to receive money. And the membership of a 501c6 or a 501c4, but as members can be solicited by the pack and the cost of soliciting be paid by the parent. And that, obviously, is very advantageous. We've had a number of organizations recently, 501c3 membership organizations that decided that they wanted to have a (pack) and they had to go through some restructuring to have two organizations, one of which, the c6 or the c4 would be able to have a (pack) and be able to solicit its members while keeping the education and charitable activities in the 501c3.

Usually a (pack) doesn't have members -- its own members. It usually has by-laws and is typically not incorporated, although required to have a treasurer who is responsible for all of the fund raising and disbursement.

Now I just mention (allied) organizations here because, I mean, they are loose affiliations, typically for things such as advocacy efforts, legislative coalitions, perhaps some research activities or trade-show sponsorships where it may be kind of on a temporary basis, you know, for one congressional cycle, perhaps, when certain legislation is important to the organization and a couple of different organizations. Or a simple trade-show sponsorship as opposed to jointly running a trade show. Sometimes there are contracts entered into. Sometimes (MOUs) or letters of agreements. Not usually incorporated, although if long term we now see LLCs as an option for structuring these affiliations. And I'll talk a little bit more about LLCs in a few minutes.

These efforts may involve sharing of expenses or one organization may pick up part of the tab and another organization picks up another part of the tab for the expenses for the organizations. Usually it would be something that would be consistent with the (taxes) and status of the different organizations. Probably, many of you have had such informal, loose affiliations. We don't typically see the absolute need to have a contract for a legislation coalition, for example, and could be a little more loose. But I mentioned here just so that in talking about the other different types of affiliates that there's some context for that.

I'm going to go on to affiliates and chapters. These are very important components of many national organizations, c3s, c4s, c6s. And sometimes there are membership requirements in that the member will -- the person will -- or either the corporation or the individual member will have to be a member of, say, the local chapter and the national or the state chapter and the national or even the local, state and national. And there could be revenue sharing that goes on. And I think it's best. And usually it's the case that if there are chapters or affiliates like we're talking about here, that they'll be referenced in the parent's by-laws and since

authority for establishing the chapters is in the parent's by-laws. Sometimes it springs up the other way and the chapters will begin in different parts of the country without the parent association being very involved. I think it's always best to have a good line of authority, of you will, or a paper trail or just some way to connect the dots when you have different chapters.

We've had a number of questions come up with organizations that aren't really exactly sure what their chapters are. And that may not seem as unusual as you might think. If the chapters are sort of small, they may not be separately incorporated. There's -- it's just kind of -- it's a little blurry as to are those chapters part of the national organization or are they separate? If they're unincorporated, it's a little hard to tell. And a lot of times they act like they're just part of the organization and the parent organization may actually pay some of their expenses and manage them to a certain extent. Well, obviously, if that incorporated association or a chapter is out there doing things that, perhaps, are a little bit over its head or entering into contracts, ((inaudible)) contracts, et cetera, that could give rise to liability, you want to make sure that that is at least known and protected against because otherwise you could find yourself, as some of our clients have, having to foot bills for the activities of chapters that really weren't authorized by the parent but that kind of fall in the area of, well, we'd better take care of it or the chapter is going to be in big trouble.

Also, plaintiff lawyers may decide, well, there's no point in just, you know, going after the chapter. They have the same name as the national. Let's go after the national, too. So it's very important, I think, to clarify the relationship of chapters. If they're separately incorporated, they'll need their own tax exemption, file the annual information return on Form 990. They'd have to have insurance. You know, the typical liability protections that

parent organizations have, maybe on a lesser extent, the chapter should have. So unincorporated, you know, and they're separate, the chapter individuals could be personally liable. If they're part of the parent then usually you would figure that out by noting that the chapter's revenue and expenses would be on the parent's 990, although that's not typically the case. So you can see how it would be a little bit murky sometimes.

A great benefit, if you have an organization that does have chapters and affiliates, and we see them all different stages of growth, if you will, is the group tax exemption that's available from the Internal Revenue Service. It does not require filing a separate form 1023s or 1024s. Essentially, the parent says, I have these subordinate organizations. They're willing to be included in the group organization. And basically write the letter to the IRS, listing the organizations and saying, they're all the same tax status. They could be 3cs or c4s or c6s. They don't have to be the same as the parent although that's usually the case. And simply by providing that group tax exemption information to the IRS, all of those entities can become exempt and don't have to through the fees and the hassle which a lot of time, local volunteers just aren't always up to a separate tax-exemption application, separate incorporation. Well, I guess separate incorporations; if they were separately incorporated they would still have to do that.

But group tax exemption can be quite a benefit and also, the affiliates and the chapters can file a consolidated 990 return. It can't be consolidated with the parent but it can be consolidated and that may work well out for some organizations, too.

So that's another type of a relationship. I mean, you can see, I think -- and I have a little more on chapters but many of the nonprofit national organizations, today, will have a number of affiliates that are really part, or part of fulfilling the organization's mission.

With chapters in particular as I've been preaching a little bit, here, I think it's really important to have the relationship papered, to have a charter or affiliation agreement that, in particular, provides for a license for use of the parent's name, logo, membership list, content, et cetera, but in particular, the name. If, for some reason, there is a falling out, if chapters go their own separate ways, it isn't the case that they should be able to continue to use the parent's name and marks. And to allow that would be potentially considered naked licensing and would result in diminishing value of the parent organization's trademark -- trademarks and intellectual property. So that's a key aspect of these affiliation agreements.

But if there's transfers of funds, either upstream or downstream, or, perhaps both, the handling of dues payments, all those should be laid out in the agreement as well as the obligations of the parents -- of the parent and the chapter.

In addition, determination provision. How is the charter revoked? And as I indicated briefly before, it is advisable for chapters who oftentimes don't have -- many chapters can be bigger than the nationals or, you know, are very, very substantial in size and scope and number of staff, revenues, sophistication, but many are also, you know, might be managed by one person, if that, or completely by the volunteers. It is important, I think, to have policies and procedures to minimize the risks. We have seen a number of hotel attrition claims or hotel cancellations claims brought against -- that were caused by local chapters, end up

being paid for by the nationals because that's just how it ends up after the chapter may overextend itself.

Ok. We'll move on, again.

International affiliates are -- can be a number of different types, really. It depends on the organization. But they could be, you know, anything outside the US and they could be like chapters. Like, say, you may have a Baltimore, Maryland chapter. You might have a London chapter. Or they could be affiliates in the sense of being sister or brother organizations in terms of national organizations in other countries that are -- would be equivalent to the U.S. national organizations, in which case they would be sort of on the same level. And may even be a part of a global umbrella organization. There can be a lot of permutations to this structure, I think.

A couple of key things here.

One, still, a written affiliation agreement particularly if they're, you know, local chapters like -- or affiliates. At that level, if you're part of a global umbrella organization, there are probably by-laws and an umbrella overall organization that would have, you know, rules and structural requirements, provisions, et cetera.

But it's important to understand the -- understand and clarify the relationship, perhaps most importantly with respect to use and registration of intellectual property because, you know, you'd hate to find out if you were the global widget association or the international child keeping. that was probably not a very good word -- a child-rearing organization to find

out that you'd -- there was another organization in another country that essentially took your name even though you had most of the gravitas -- most of the revenues, resources, et cetera. So use and registration of intellectual property in the international field, I think, is very important.

Now we're going to push on a little bit to the last couple of issues which I think many people -- you know, when they think of nonprofit organization affiliates would think of corporate relations and business ventures as the key thing that they'd be interested in.

In this overview presentation, I wanted to lay out all the different types that I could really think of, or at least, most of the types I could think of and put that into some perspective. There's a whole area of corporate relations and I'll cover it as quickly as I can here and also business relationships that may be subject to a lot of further discussion.

I also might make note that at the ACC annual meeting on Tuesday, October 24, there will be a session on for-profit subsidiaries protecting assets while expanding access to capital where we have representatives from American Cancer Society, AARP and my partner, Jerry Jacobs. And so, if you're out in San Diego for the meeting, you may want to check that out. We also may consider doing further Webcasts on some of these areas.

Let me talk briefly about, sort of, overall corporate relations and this really is a wide spectrum. Wide varieties of corporate support for organizations. And it may be just donors, supporters of many different -- referred to in many different ways; members, regular associate members, exhibitors.

Corporate sponsorship has obviously been a very hot issue since 1993 when the IRS brought this up in the infamous Mobile Cotton Bowl case. The IRS has certainly wanted to treat corporate sponsorship revenues as advertising. Indeed, many corporate sponsors may actually categorize their corporate sponsorship payments as advertising. I mean we certainly see it in the sports area; nonprofit organizations that run golf tournaments or college football games or bowls, et cetera. You know the name of the corporate sponsor is all over, everywhere and that would seem to be advertising.

But the outcry after the IRS went down this road in the early 90s was just unbelievable with Boy Scouts and Girl Scouts and local symphonies and you name it in terms of the number of different types of nonprofit organizations that said, 'Hey. We get most of our money from Joe's Cleaners and we want to be able to put Joe's Cleaners' logo on the back of our jerseys.' Or we want to be able to recognize our local sponsors. And if you tax that we would be dead. So Congress did pass a corporate sponsorship rule. I mean, it's very, very important. Many organizations take advantage of it. I would guess that most of you take do. And as long -- the basic rule-of-thumb is that as long as you're just recognizing or sponsoring, as long as the corporation is just -- I'm sorry. As long as the nonprofit tax-exempt organization is just recognizing or sponsoring, its corporate sponsors, that shouldn't be a problem. It's very similar to the -- if you listen National Public Radio, public radio and television stations when they say, 'Thanks to our sponsors, so-and-so worldwide manufactures computers', those types of sound bites that recognize the sponsor even with an established slogan, are ok in terms of recognizing sponsors. If it gets into advertising, then those amounts can be subject to unrelated business income tax and you certainly would want to have the money tax-free if you could and so those rules are very important. And usually the sponsors don't mind that much how the relationship is recognized as long as they get good relationship.

We have many organizations that participate in affinity or preferred provider type programs, mostly membership organizations where a vendor will be interested in providing its product or services to the members of the organization, hopefully, at a discount or some other value-add. And the organization -- the nonprofit organization is asked to lend its name and logo and mailing lists to the vendor who then markets the program to the members. And this was also attacked by the IRS for many years because they viewed the mailing-list aspect of it as making the royalty payments not passive and, therefore, subject to tax. I have to note, briefly, then an exception to unrelated business income tax or -- is made for passive royalties -- passive revenues which include dividends. That's how you continue to make money off your stockholdings, et cetera. Interest, same. Certain rents, non-debt finance rents. Royalties. Royalties has been kind of a key battleground here because the proper characterization for revenue streams resulting from use of license of intellectual property, including trademarks or copy writes would be considered a royalty. And as long as it's passive and the organization isn't actively marketing this affinity or similar-type program, then the royalty will remain tax-free.

Many clients of ours also have -- and many organizations who are not clients of ours but, you know what I mean, have set up bifurcated arrangements whereby the parent will license its name and logo to -- and perhaps mailing lists if that's an issue, to the vendor and a for-profit subsidiary will handle all marketing and will get a portion, usually a small portion of the revenues being paid by the vendors. And this is a pretty good way to be able to aggressively market through an arm of the nonprofit organization, the programs and yet maintain the tax-free nature of most of the revenue that goes back directly to the tax-exempt organization.

Cause-related marketing programs are very similar. Conducted more by charities and membership organizations because the difference between affinity programs, as I sort of construct it, is that it's not marketing to members, it's marketing to the public. So you might have all different -- you've seen it in the grocery stores. You've seen it on TV. Marketing, for example, Children's Television Network puts some -- allows or licenses the images of some of its Sesame Street cartoon characters on shampoos or soaps or toothpaste. And those products are sold by the vendor saying that a portion of the proceeds will be going toward the tax-exempt organization. That's generally considered cause-related marketing.

It follows a similar structure in that the revenue -- the proper characterization of the revenues would be royalties and as long as the organization is passive, which usually it wants to be because you don't want to be out there marketing vendor products to the public, it can be a great source of revenue provided that you have interested corporations who want to be able to use your name -- your organization's name to get their product out. It does come with a few slippery slopes. You have to be careful that you don't pick the wrong vendors to do this in where you get a bad name if your products -- the products of the vendor, you know, don't perform well or the services are not very good. But with some due diligence you can -- this can end up being a, you know, a reasonably good program.

So in corporate relations that's kind of an overview of that type of activity.

Now we're going to get to just about the end here. But we'll have some discussion about business forms used in ventures between nonprofit organizations and for-profit corporations.

We see it in a lot of areas. I mean, typically, for example, trade shows would be considered an exempt activity for a trade or professional association or a charitable membership organization. Many publications are also exempt activities. However, a lot of time nonprofit organizations would like to have some additional resources to be able to promote its activities, its trade-show publications, other development opportunities. I mean, it's -- hospitals, universities, et cetera, find willing partners in for-profit organizations to conduct their more business-related activities.

Most of what we've seen over the years kind of went into the joint venture or partnership category and would be essentially contractual in nature. Joint ventures and partnerships, you know, work well. There's the issue of liabilities that may go straight through the partnership if there is liability. Typically the revenues will flow through in the same manner that if the nonprofit organization would be doing them but that there could be some liability there. And the law around partnerships and joint ventures is also a little bit murky in some areas and there -- you know, there's always a fear of, you know, joint liability in undertaking that kind of a structure for a venture.

What we see now and we use -- have used an awful lot in the last few years are limited liability companies which I think most states now permit. They are basically a corporation but, for tax purposes they're like a tax nothing. The flow through. So you get one of the benefits that is not in a partnership of having the corporate liability protection but you also get the benefit of having the money flow through.

Now the key issue that we've been wrestling with in many of these situations is, while obviously the for-profit entity would like to have control because they may be putting in a

lot of the resources to the activity -- but in order for the exempt organization to be able to continue to claim that the revenues that flow through the LLC are tax exempt and not taxable as a business activity, essentially, the exempt organization must maintain effective control over the organizations, over the LLC or the partnership. Again, this has been coming up more recently most often with LLCs to make sure that the revenues are tax-free.

And how is that effective control provided? There are a couple of IRS Revenue rulings. What we've seen is, and the things that we try to get, if you will, in the relationships are a majority ownership of the organization, even if it's 51 percent by the tax exempt; majority control of the Board of Directors; or with an LLC, called the managers, maybe called a Board of Managers, what-have-you so that there is control.

When some of those preferences have run into, I guess, some difficulty or some resistance by the for-profit corporations we've also tried to include provisions in the Operating Agreements of the LLC that the tax-exempt organization will have an effective veto. If anything that is proposed to be undertaken by the LLC might not be tax exempt in its nature and purpose that would potentially jeopardize the tax-free nature of the revenues and also, potentially, the tax-exempt status of the tax-exempt organization.

So there's some key control issues that you may find you have experienced already if you've worked on these types of business forms. And if you haven't, I would think that you will face some of those issues. There is some pretty good guidance out there, as I say. And so that may be helpful.

We are hopeful that, as we pull together this info pack and I'm working with (Audra Hegmi) here in our nonprofit organizations practice to do that for ACC, that we're able to get a number of good resources in all of these areas. You know, not just sites to IRS rulings or statute regs and cases but some -- hopefully some helpful practice tips, sample forms, that type of thing because it -- it's kind of a wild world out there.

As you can see as we've gone through this presentation that there are an awful lot of different type of affiliates that nonprofit organizations now days are interacting with -- you know, with some potential jeopardy, but on the positive side, with a lot of potential upside.

So, Steve, I think actually that that may be my last slide. And so, as you know, I hadn't planned on looking at the little question box for questions and maybe we don't have anybody and everyone's asbed, asleep or maybe we do have a few ...

Steve Garrett: We do.

Jefferson Glassie: ... people ((inaudible)) try to answer them as best I can.

Steve Garrett: Let me just jump in here and pose a few of these questions. We've had a few of these attendees submitted some in. And for your info pack, one of our attendees does have a question about that same ((inaudible)) will the info pack include an example of a chapter affiliation agreement. So you might want to put that on the checklist and talk to your folks about ((inaudible)) might want to include something about that one.

Jefferson Glassie: Steve, I can guarantee that there will be a sample chapter affiliation agreement in the info pack.

Steve Garrett: Great. I'm sure our -- one of our attendees sent in that question will be glad to hear that.

One of the other questions that was posed is that they are especially interested in nonprofit essentially being seen as more transparent from a fiscal and corporate (government) perspective as opposed to LLCs or other forms of for-profit entities. I guess the question is -- and I was thinking about this, myself, is that for subsidiary, you can use a -- in our case, we've used a non-exempt nonprofit organization. We weren't worried too much about the tax exemption as we were about certain protections but also ease of maintenance of the corporate form, regulatory requirement and things like that. And in our particular situation, that's what we did. It was -- it worked out to be the best solution.

Now I was wondering if you've had any thoughts about that as well, in terms of ever setting up a non-exempt -- using the non-exempt advantages of a nonprofit organization.

Jefferson Glassie: Yes. That's a great question and a great point. And I should have mentioned that we do have a few organizations that decide, well, you know, we do want to have a separate entity for liability purposes or just for perception purposes as was indicated by the questioner but it's not that important or maybe the revenue stream is not that significant or maybe the expenses are just going to wash out against the revenues. It's not that important to be limited by the tax exemption rules, which can, you know, pose a number of considerations and extra time and resources just trying to figure out. So I think that's -- you

know, that's an excellent suggestion and could be a very good way to go and it will be added to the slide presentation if I do it again.

Steve Garrett: Yes. I've got two more. One's a little shorter and another is a little more involved.

Let's take the shorter one, first.

It's -- and the questioner is asking if you can speak more about the parent staffing its subsidiaries and sponsored organizations. What legal and tax issues need to be considered. I'm assuming that has to do with more of a veil-piercing liability aspect.

But also, too, I was going to ask you to broaden just a little bit and talk about, in terms of Workers Comp-type issues that may come in.

Jefferson Glassie: Another good question and -- I mean, what we've seen almost invariably, although some organizations that are very large, as I say, the affiliate for-profit or nonprofit, some of them will have their own employees. But in the -- most of the cases I can think of, the staff is provided by the parent for benefits reasons, a lot of efficiencies, et cetera.

In terms of piecing the corporate veil, I don't think that there's any untoward fraudulent or illegal conduct going on when -- I mean it's really very common to lease employees to another affiliated organization for 50 percent of their time or 25 percent of their time, et cetera. And I think as long as it's an insurance for the separate organization as well, many times insurance will be -- like liability insurance, the affiliate will be named under the parent organization's policy, I assume for Workers Comp and for other purposes, that would be the case.

I mean, I don't see that as something that would be a flash point for liability in piercing the corporate veil as long as it's all papered and accounted for correctly.

Steve Garrett: All right. The next question -- well, just a little bit of a follow-up, I know that some people are concerned about the UBIT issues that may come in on operations subsidiary.

In our case, we take the nonprofit lines that, I guess, a little bit further and we usually structure our cost for management fees or services that we provide for subsidiaries, basically, on a ((inaudible)) and so it's a wash. What little we may have that ((inaudible)) but that is -
- it's really a minimum for us.

So if you think about how you structure and what the purpose is, I think you can come up with a different scenario that you may well see. In a high-risk one, you may want to separately staff if you really feel that somebody may be after you. If something goes wrong in your subsidiary operations then take that into account and set it up accordingly.

Jefferson Glassie: Exactly right.

Steve Garrett: The last one, I'm -- it's not really so specific so much as a -- to a subsidiary but it could be. And let me pose this one to you about -- I think our questioner may need to just go send you the e-mail separately later on. But just -- I think it's a great question just for everybody thinking about things that can come up.

And this one says that -- it refers to setting up scientific intellectual property based standard setting organization as a tax-exempt member corporation. Now it's not an IT tool but an IT specification drafting licensing enforcement entity. It would have members in the hundreds and it would be one entity well suited to handle administrative as well as licensing aspects. Ask you to look at it in terms of potential benefit of flexibility from antitrust, litigation, tax for-profit business affiliation or related (perspectives).

I mention this one because of a lot of the activities of nonprofit organizations have gone well beyond the traditional thing when people think of nonprofits, what you're all involved in. This one, I think, is a great example about all kinds of complexities that could come up. And you might -- I'm not sure how they're thinking about setting this one up, but it might be that certain aspects of this could be carved into subsidiary organizations to kind of address or quarantine some of the issues that may come up.

Jefferson Glassie: Yes. Definitely. I mean, that's -- I'm not sure I have gotten a full grasp on exactly the question and nature of the activity. But, you know, there are, as we've discussed, a number of tools to be able to structure that type of activity separately to minimize risks, maximize tax-exempt revenues and, you know -- we have looked at antitrust and IP and a number of different things in analyzing these new affiliated organizations. It really does depend on the facts and circumstances related to that organization.

I just thought of one other thing I meant to mention. The many nonprofit subsidiaries, we generally just taken the position that it's ok for the parent to appoint the Board and that should be sufficient control along with the contracts and -- you know, there may be a loan and some other things. Some groups have had the parent also be a member of the nonprofit

organization and control, not just the Board, but also be the sole member, kind of like a sole shareholder. It adds a little bit of complexity but probably a little bit more security for those who are so inclined. So I just wanted to add that point.

But, Steve, I think it would be, perhaps a little bit of offline discussion for the other question.

Steve Garrett: As a matter of fact, the way we set one of ours up was to have a sole -- the parent corporation is the sole member. It does -- I think it does add a little bit of the extra protection into the corporation. The parent corporation is the member, not the Board, itself although it has the right to appoint it.

Jefferson Glassie: Right.

Steve Garrett: That's a little distinction and some nuances there that kind of come in.

Last question I have is -- for you is -- the questioner is asking -- he says, can too much tax-exempt revenue jeopardize 501c4 status?

Jefferson Glassie: Too much ...

Steve Garrett: Tax-exempt revenue jeopardize 501c4 status. And I'm not sure if they're thinking ...

Jefferson Glassie: Well, AARP has -- makes about a billion dollars a year ...

Steve Garrett: Yes.

Jefferson Glassie: ...and that doesn't have an effect. I mean, I should have mentioned too much unrelated revenue, UBIT revenue, clearly can jeopardize tax-exempt status, maybe 40 percent, 50 percent. You're really at the danger line there and that is another reason to set up a for-profit subsidiary for a subsidiary to handle the appropriate kind of activity. I should have mentioned that ((inaudible)) but that's a good question.

Steve Garrett: All right. And I think we are just about out of time so let me go ahead and just close this out by saying that all this does now conclude our Webcast today.

And I'd like to thank Jeff for his time and his excellent presentation. I also want to thank his firm, Pillsbury Winthrop Shaw Pittman for sponsoring our Webcast.

And just as a little plug for the nonprofit organizations committee at the annual meeting in San Diego, we will have our business meeting on Tuesday, October 24 and I'd like to invite all of our attendees to come and see if you'd like to come join our committees.

We also meet the second Tuesday of every month, teleconference and if you'd like information on that you can either contact me or (Jackson Winley) at ACC.

Jefferson Glassie: Hey, Steve...

Steve Garrett: Yes...

Jefferson Glassie: I have just two quick things. One, I just noticed on the slide that my e-mail ...

there's one typo. It's jeff-dot-glassie. That doesn't appear to be on there. Sorry about that.

And, you know, as long as you're talking about the annual meeting, we're sponsoring a reception on an aircraft carrier for the nonprofit organization committee attendees so come on down.

Steve Garrett: I think we'll have a good time. I'm looking forward to that.

I need to remind the audience that the audio file for the Webcast is available on the ACC Website. It will be available -- I think it will be posted about three hours from now. It will be archived there for about a year.

And I want to thank our audience for attending our Webcast. And remember, if you have any questions related to today's topic you can send them to Jeff and that e-mail address is Jeff at J-E-F-F-dot-glassie-G-L-A-S-S-I-E@pillsburylaw.com.

And a final comment I'd like to remind everybody, please complete the Webcast evaluation form which is found, I think, in the links box and -- because that information is very useful to ACC in scheduling and planning other Webcast events.

And with that we'll be signing off.

Jefferson Glassie: Thanks, Steve.

END

ASSOCIATION OF CORPORATE COUNSEL

Moderator: Steven Garrett

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Page 32