708 For-Profit Subsidiaries: Protecting Assets While Expanding Access to Capital

Jerald A. Jacobs
Partner
Pillsbury Winthrop Shaw Pittman LLP

Timothy B. Phillips
Associate Corporate Counsel
American Cancer Society

Joan S. Wise
General Counsel
AARP

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).
Materials may not be reproduced without the consent of ACC.
Reproduction permission requests should be directed to Julienne Bramesco at ACC: 202/293-4103, ext. 338; bramesco@acca.com

Faculty Biographies

Jerald A. Jacobs

Jerald A. Jacobs is a Washington, DC attorney and head of the nonprofit organizations specialty practice team of the Pillsbury Winthrop Shaw Pittman LLP law firm, which provides legal counseling and advocacy for over 200 national trade associations, professional societies, and other nonprofit organizations. He is also head of the public practices section of the firm. Mr. Jacobs has been active in the legal representation of nonprofit organization clients for many years. His practice includes antitrust and trade regulation, health law, litigation, nonprofit corporate governance and transactions, federal income tax exemption, and federal legislative and regulatory issues affecting nonprofit organizations. He has advised the governments of the European Union and the People's Republic of China on nonprofit organization legal policy.

Mr. Jacobs is general counsel for ASAE & The Center for Association Leadership, the 20,000-member national professional society of nonprofit organization staff executives; and he has been the keynote speaker at ASAE's legal symposium. Mr. Jacobs has authored or edited nearly a dozen texts on nonprofit organization law, including the standard Association Law Handbook that is being published in its fourth edition this year.

Mr. Jacobs holds undergraduate and law degrees from Georgetown University.

Timothy B. Phillips

Timothy B. Phillips is associate corporate counsel with the national home office of the American Cancer Society, Inc. in Atlanta. He specializes in the areas of taxation, nonprofit governance, risk management, compliance, employee benefits and executive compensation, grant reviews, vendor contracts, and collaborative efforts with foreign cancer fighting entities.

Prior to joining the American Cancer Society, Mr. Phillips was in private practice in the Atlanta office of Troutman Sanders LLP, where he was tax counsel to multiple charitable, educational, and religious organizations, trade associations, business leagues, and social welfare organizations in connection with their applications for recognition of exempt status and joint ventures with for-profit entities.

Mr. Phillips frequently lectures on the formation and operation of tax- exempt organizations. He also co-authored The Forming of Non-Profit Tax Organizations in Georgia. Mr. Phillips currently serves as the president of the Atlanta Volunteer Lawyers Foundation, a nonprofit organization dedicated to providing equal access to justice on a pro bono basis through the efforts of volunteer attorneys. He also serves on the board of directors of the Naval Academy Alumni Association, Atlanta chapter, and the Atlanta Bar Association's section of taxation. He is a member of the State Bar of Georgia and the Atlanta Bar Association.

Mr. Phillips received his B.S. degree from the U.S. Naval Academy and his J.D. degree from the University of Virginia.

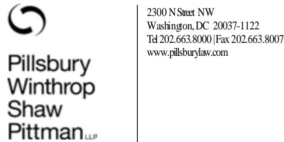
Joan S. Wise

Joan S. Wise is general counsel of AARP in Washington, DC. As general counsel, Ms. Wise represents AARP's interests in legal matters in order to protect AARP's image, name, programs, and services. She is counsel to the AARP board of directors. She also addresses legal issues to prevent legal problems arising by working closely with staff and volunteers as new programs and projects are developed.

Ms. Wise joined AARP's office of the general counsel as an attorney. She has held a series of increasingly responsible positions, serving as associate general counsel before assuming the position of general counsel. Ms. Wise led many projects and activities at AARP, handling regulatory, non-profit, and intellectual property issues, and advising and educating staff on compliance and other legal matters. Prior to coming to AARP, she was a staff attorney to the Attorney General of Maryland, as well as an assistant attorney general for consumer protection in the Attorney General's Office.

Ms. Wise holds a B.S. from the George Washington University and an M.A. from the University of California. She graduated from the Georgetown University Law Center with a J.D., where she was a founding member of Women in Law as a Second Career.

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).



2300 N Street NW
Washington, DC 20037-1122
Tel 202.663.8000 | Fax 202.663.8007
www.pillsburylaw.com

Association of Corporate Counsel
ACC's 2006 Annual Meeting San Diego
Subsidiaries of Nonprofit Organizations

Jerald A. Jacobs, Pillsbury Winthrop Shaw Pittman LLP, Washington, DC

Outline Primer

1. Nonprofit/Tax-Exempt. Distinguish "nonprofit corporation" from "federal income tax exempt organization."

2. Exemption Categories. Primary categories of federal income tax exemption available to nonprofit organizations ("IRC" references are to "Internal Revenue Code"):

a. **IRC Section 501(c)(3)** – religious, charitable, scientific, literary, or educational organizations. Exclusive category where donations eligible for charitable contribution deductibility beyond value of what is received in return. Subject to "exclusivity" rule. Limitation on lobbying [but mathematical test available under Section 501(h)]; absolute ban on political campaign activity. Subject to "excess benefits" regulations under IRC Section 4958. Subject to IRS "commerciality" doctrine. Closely guarded by the Internal Revenue Service ("IRS"). Closely examined recently by the Senate Finance Committee.

b. **IRC Section 501(c)(4)** – social welfare and other "cause" or "issue" organizations. No limit on lobbying; political campaigning must not be primary activity. Subject to "excess benefits" regulations under IRC Section 4958. Recently subjected to IRS policy on "commerciality."

c. **IRC Section 501(c)(6)** – "business leagues" trade associations, professional societies, chambers of commerce. No limits on lobbying or political campaigning (if the latter is not primary activity); political campaign contributions subject to tax under IRC Section 527(f) in states where corporate contributions permitted. Dues not deductible to members as "ordinary and necessary business expenses" to the extent of the organization's lobbying and political activity pursuant to IRC Section 162(e)(3).

3. Unrelated Business Income Tax. All categories subject to IRC Section 512 on unrelated business income tax ("UBIT") where: (a) a "business" activity, is (b) "regularly carried on," and is (c) "not substantially related" to the organization's exempt purposes (i.e., does not "contribute importantly" to exempt purposes per U.S. Supreme Court). Net financial gain (i.e., revenues less expenses) from all of an exempt organization's UBIT-eligible activities (i.e., where gains exceed losses) is subject to regular federal corporate income tax. UBIT generally does not apply to rent, royalties, interest, dividends or capital gains (with exception for debt-financed assets).

4. "Substantial" UBIT. Where an exempt organization realizes "substantial" UBIT-eligible revenue (whether based on gross revenue, net revenue, personnel involved, etc. is unclear), the organization will no longer qualify for exemption; there is no clear level or percentage to determine what is "substantial." Most common activities generating UBIT-eligible revenue include: advertising, insurance, fee-based individual consulting/testing, etc. Trade show/exhibition revenue has statutory protection from UBIT treatment under IRC Section 513(d)(3)(B).

5. Reports and Returns. Exempt organizations file a Form 990 informational report to the IRS annually; Form 990 is undergoing revisions by the IRS. This is a public document, which will be released by the IRS upon request; an exempt organization's last three years' Forms 990, its request for exemption and exemption determination letter from the IRS must be made available by the exempt organization itself in response to a request from the public under the provisions of

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

IRC Section 6104. Exempt organizations with above-threshold UBIT revenue must file a Form 990-T income tax return; it is kept confidential by the IRS (although there have been proposals to change the confidential status of Forms 990-T).

6. Taxable Subsidiary. When UBIT-eligible revenue threatens to become "substantial," the activity(ies) generating UBIT-eligible revenue can be transferred to a wholly-owned taxable subsidiary corporation to avoid jeopardizing tax exempt status of "parent" exempt organization. Other reasons for forming a subsidiary include: (a) encouraging entrepreneurship in particular endeavors, (b) separating from the parent exempt organization activity that has singular legal liability, (c) developing streamlined or different governance structure from that of parent, etc. Beware, however, of the "mere instrumentality" rule permitting parent and controlled subsidiary to be considered as one.

7. Passive Income from Controlled Taxable Subsidiary. IRC Section 512(b)(13) subjects revenue to UBIT for the parent exempt organization where the revenue comes from a controlled subsidiary and is in the form of rents, royalties, or interest. "Control" of a corporation is ownership of more than fifty percent of the stock.

8. Other Controlled Entities. Exempt organizations often have tax-exempt affiliates for special purposes and activities; it is common for an IRC Section 501(c)(6) organization to have a "controlled affiliate" exempt under IRC Section 501(c)(3) for education, endowment, research or other such purposes. The controlled affiliate "foundation" may avoid private foundation status by demonstrating broad public support or via "supporting organization" status under IRC Section 509(a)(3).

9. Shared Ventures or Endeavors. An exempt organization might "share" some program or activity with another exempt or taxable organization. Typical structures include:

a. **Contract Joint Venture** -- an agreement between the sharing entities on purposes, control, costs, revenue, etc.; provides no ability to limit parties' liability as with LLC or corporation; simple, efficient, low-maintenance; no statutory framework and thus very flexible.

b. **Limited Liability Company** ("LLC") -- a separate state-chartered entity with liability protection for the owners/members and generally, as with a partnership, no tax status of its own; especially useful for nonprofit/for-profit ventures on programs which would qualify for tax exemption such as education, trade shows, etc. where nonprofit participant can "control" the venture and realize exempt income; some maintenance required; little statutory framework facilitates flexible governance provisions; most modern form of joint venture.

c. **Tax-Exempt Nonprofit Corporation** – a separate state-chartered entity with liability protection for members and exemption from federal income tax if it meets IRC qualifications; control is shared via board seat election/appointment, bylaws approval, long-term agreement or otherwise; no true "ownership" for nonprofit corporation and therefore sometimes risks "runaway" subsidiary situation; some maintenance required; statutory framework guides governance.

d. **Taxable Business Corporation** ("C" corporation) – a separate state-chartered entity with liability protection for shareholders; control is via equity ownership by shareholders and is absolute; some maintenance required; very detailed statutory framework and common law guides governance.

10. Sponsorship Relations with Businesses. Exempt organizations may have relationships with businesses in which: (a) the exempt organization "sponsors" the business's products or services in return for tax-exempt "passive" royalties for the exempt organization (beware exempt organization involvement in administration or marketing of the products or services); or (b) the business "sponsors" a program or activity of an exempt organization by making a sponsorship payment to the organization in return for recognition and visibility [beware active assistance by

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

the exempt organization in marketing on behalf of the sponsoring business under IRC Section 513(i) lest the sponsorship payments be treated as subject to UBIT].

11. Relationships between Exempt Organization Parent and Subsidiary/Affiliate. Where exempt organization parent and subsidiary/affiliate have separate tax statuses, care should be taken to treat each separately – separate bank accounts, separate meetings, separate minutes/records, and possibly some non-overlapping directors/officers. It is especially important to document the "separate-ness" of the two organizations to avoid IRS "collapsing" the two into whichever one has the least-desirable tax status.

12. Relinquishing Exempt Status. Benefits from federal income tax exemption are manifest – especially not being subject to income tax on net revenues. Admittedly, a web of often vague regulations/requirements accompanies the benefits. Before considering relinquishment of exemption, review IRC Section 277, which limits deductions available to offset membership income in taxable membership organizations; very little interpretation is available; Section 277 could significantly restrict the advantages of relinquishing exemption for an entity with significant membership income.

Association of Corporate Counsel
ACC's 2006 Annual Meeting
For-Profit Subsidiaries: Protecting Assets While Expanding Access To Capital

TAXABLE SUBSIDIARIES OF TAX-EXEMPT ORGANIZATIONS

Timothy B. Phillips, Associate Corporation Counsel, American Cancer Society, Inc.[1]

I. INTRODUCTION

There are many motivations for a tax-exempt organization to create a taxable subsidiary. The tax-exempt organizations which are described in one of the many subsections of Internal Revenue Code (the "Code") Section 501(c) are generally exempt from Federal income tax so long as they are organized and operated exclusively to further one or more purposes constituting the basis for tax exemption. When such organizations engage in activities not substantially related to their exempt purposes, the income derived from the activities may be subject to the tax on unrelated business income; or, when the unrelated activities are substantial in relation to the exempt function, the organization risks having its exempt status revoked. For example, a Code Section 501(c)(3) charitable organization may jeopardize its tax-exempt status if it fails to operate exclusively for charitable purposes, engages in prohibited political campaign activities or substantial lobbying activities, or operates in furtherance of substantial activities not related to its charitable purposes.[2] Creating a taxable subsidiary could solve many, if not all, of these issues for charitable and other tax-exempt organizations. While creating and properly maintaining a taxable subsidiary may create overly burdensome challenges or prove impractical for some tax-exempt organizations, it is common, if not frequently essential, for certain exempt organizations to form a taxable subsidiary.

II. WHY WOULD AN EXEMPT ORGANIZATION WANT TO FORM A TAXABLE SUBSIDIARY?

Preventing unrelated business income from jeopardizing exempt status.

One of the most common reasons for an exempt organization to form a taxable subsidiary is to protect its tax exempt status from the threat of unrelated business activities and income. A tax-exempt organization must be operated exclusively for its

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

exempt purposes, and if it conducts activities that are similar to a commercial enterprise, this requirement may be violated.[3] An exempt organization may want to prevent the activity which generates its unrelated business income from becoming too substantial an activity, thereby jeopardizing its tax-exempt status. Even if an unrelated trade or business undertaken by an exempt organization does not jeopardize the exempt status, the organization will still be subject to the tax on net income that it derives from the unrelated trade or business.[4] Although passive income, such as rents, royalties, dividends, interest, payments with respect to securities loans, annuities, and income from notional principal contracts, is generally excluded in computing unrelated business taxable income, if these activities become too substantial, the tax-exempt status of an organization may be threatened.[5]

Taxable subsidiaries allow exempt organizations to manage their exposure to potentially excessive unrelated business activities or income.[6] As a general rule, if an exempt organization operates a trade or business as a substantial part of its activities, this trade or business must be in furtherance of the organization's exempt purpose or purposes, i.e., the organization cannot be organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in Code Section 513.[7] If the unrelated business activity becomes too substantial, the organization will be deemed to be operating for other than exempt purposes and will not qualify for tax exempt status.[8] The presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption.[9] Exempt organizations generally seek an objective standard to determine how much unrelated business activity can occur before the activity becomes too "substantial." Unfortunately the Code and Regulations do not provide a threshold level of allowable unrelated business activity.[10] However, the IRS does stipulate that the relative size of unrelated business income activity should be compared to the organization's total activities and consideration given to:

1) The relationship of the business activity to the overall activities of the organization in terms of time, effort, and dollar income.
2) The relationship between the business activity and the exempt function of the organization.
3) The reason that the organization conducts the particular business activity.
4) The methods of operation and the control exercised by the board of directors or trustees over the business operations.[11]

Thus, based on the risk of jeopardizing its tax-exempt status, it may be practical for a tax-exempt entity to conduct certain business activities through the use of a taxable subsidiary. The activities which may possibly threaten the status of the exempt organization can be transferred to the subsidiary. If properly organized and operated, a subsidiary will help to shield the tax-exempt parent from the loss of its status as a result of the unrelated business activities or substantial unrelated business income.

Liability Protection

Protecting the assets of the tax-exempt organization from liabilities associated with a commercial enterprise is another common reason for moving the commercial activities to a taxable subsidiary. An exempt organization may want to immunize itself from a high-risk activity or allow different executives to participate in specific functions to promote accountability of those specific functions.[12] Often, the activities that an exempt organization cannot directly undertake can be accomplished by a subsidiary. Further, the creation of a subsidiary protects the exempt organization's assets from the debts of the separate business, such as payments owed to suppliers or lenders, or from lawsuits brought by customers or former employees.[13] A tax-exempt organization may also seek to insulate itself from liability as a result of entering into affiliate agreements with third parties.[14]

As discussed in Section IV below, exempt organizations must exercise diligence and care with a subsidiary. The most common contributing factor to the loss of liability protection for an exempt organization is the failure to establish and maintain separate legal entities.[15] If a claimant can prove that the parent tax-exempt organization and its subsidiary are not two separate entities, the parent may be liable for the claims brought against the subsidiary.[16] Liability protection may also be lost, however, if the corporation guarantees to pay certain debts of the subsidiary, such as by co-signing a

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

loan. In this case, the parent corporation would be liable up to the amount of its guarantee.[17]

- Example: A scientific or research organization may want to form a subsidiary to retain patents because the Regulations provide if an organization retains the ownership or control of more than an insubstantial portion of the patents, copyrights, processes, or formulae resulting from its research and does not make such patents, copyrights, processes, or formulae available to the public, the organization will not qualify for exempt status.[18]
- Example: In response to dramatic changes in the student loan industry, an organization may be forced to reconsider its overall operations strategy so that it will be unable to sustain its guarantor and bankruptcy services for the benefit of student borrowers. The organization may seek to form taxable subsidiaries to carry on certain activities which are highly regarded in the market place but which are not directly related to, or an integral part of its mission. [19]

Minimize State and Local Tax Liability

By utilizing a subsidiary to conduct non-exempt business activities, a tax-exempt organization may have the opportunity to select a favorable jurisdiction for purposes of state and local income tax, gross receipts, sales and use, or franchise taxes. If an organization conducts business activity in a certain amount or degree and has a substantial physical presence within, or “nexus” to, a state, the organization may be subject to that jurisdiction’s state and local taxes on its gross receipts and/or income.[20] The determination of the requisite amount of nexus to trigger state and local tax liability is made at the individual state level. Generally, nexus is created whenever an organization has a temporary or permanent physical presence of people (employees, technicians) or property (offices, warehouses) within a state.[21] Out-of-state sellers are required to collect and remit the tax on sales to in-state residents if they maintain a continuing presence in the state by one or more full time employees.[22] If a tax-exempt organization engages in business activities involving direct mail-order sales to state residents, (which generally does not create substantial nexus) but has additional connections to the taxing state, then those additional connections could be sufficient to create nexus for state tax purposes.[23]

Isolating the activities in a taxable subsidiary may decrease the risk of establishing nexus. In addition to the burden of having to collect, remit and report the tax on their sales activities, for exempt organizations that have established sufficient presence in several jurisdictions, the potential state tax liability of their unrelated business income could be costly. If an exempt organization chooses to conduct commercial activities within its taxable subsidiary where nexus is limited to a single jurisdiction with little or no state income tax, the organization can significantly decrease the exposure of its income to state tax.

Funding and Financing

A taxable subsidiary may be able to attract funding that the exempt parent would not be able to attract. Accounting for the expenditure of funds in a taxable subsidiary is easier, and it is clearer that certain funds are being devoted to the business.[24] Further, some funding and financing sources may only be available to a for-profit entity, such as loans from the Small Business Administration and access to the capital markets. Venture capital in the form of private placements, or other direct equity investment from private external sources,[25] while generally unavailable to an exempt organization, is available to a taxable subsidiary. Moreover, although taxable subsidiaries may be ineligible to receive certain government grants or foundation grants, the exempt parent may be able to use such funding to make a capital contribution or loan to its taxable subsidiary.[26]

Management Efficiency

Conducting commercial activities in an entity separate from the exempt organization may be a more efficient means of conducting business. A taxable subsidiary can utilize central management specific to a particular business function and match talents where appropriate. In this sense, the taxable subsidiary is an efficient means of combining the right people with the right expertise in the right enterprise. An exempt organization may also be able to simplify its tax filings for certain activities by setting up

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

taxable affiliates or subsidiaries which prevent the exempt organization from being subjected to UBIT filing requirements.

Flexibility in Compensation

As a general matter, a taxable entity has more flexibility in the area of compensation than an exempt organization. Some exempts may have explicit or implicit caps on employees' salaries to reflect the mission of the organization or to keep high salaries from discouraging donations. A taxable entity can also offer particular kinds of compensation to employees that are not available to tax-exempt employers, such as certain deferred compensation arrangements, participating stock, stock appreciation rights, and options of all kinds.[27] A taxable subsidiary may be better able to attract and maintain a professional staff by offering these various types of compensation packages that would normally be unavailable for the tax-exempt. The IRS provided some guidance in the area of flexibility in compensation in Private Letter Ruling 200225046 (Mar, 2002). In this ruling, the IRS reviewed whether taxable subsidiary's grants of stock to its employees would violate the prohibitions against private inurement that applied to the exempt parent. The IRS determined that so long as the compensation remained reasonable, the subsidiary's grant of such interests would not be considered contrary to the parent's exempt purpose or jeopardize the parent's tax-exempt status.[28]

The available compensation arrangements for employees of a taxable subsidiary are not unlimited, however. Section 162 of the Code subjects such compensation to the requirement that the amount paid not exceed a reasonable salary or wage.[29] Furthermore, the compensation of employees of the taxable subsidiary is also subject to the excess benefit transaction rules of Code Section 4958 where such employees are "disqualified persons" with respect to the exempt organization.[30] An excess benefit transaction is any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person, if the value of the economic benefit provided by the exempt organization exceeds the value of the consideration (including the performance of services) received for providing the benefit.[31]

Payment of compensation to employees who are considered "disqualified persons"[32] is a type of excess benefit transaction which should be taken into consideration if flexibility in compensation is a motivating factor for a tax-exempt to form a taxable subsidiary. A "disqualified person" is any person in a position to exercise substantial influence over the affairs of the organization at any time during the five-year period before the excess benefit transaction occurred.[33] Compensation for services is considered reasonable only if it is an "amount that would ordinarily be paid for like services, by like enterprises, under like circumstances."[34] Organizations that engage in excess benefit transactions are taxed under a penalty excise tax, and managers of the tax-exempt organization that knowingly entered into the transaction are at risk for receiving a penalty.[35]

III. CHOICE OF ENTITY

The choice of organizational form in creating a taxable subsidiary deserves consideration. While tax-exempt organizations may own and control for-profit entities[36] and may provide various services and assets to such entities,[37] the classification of a controlled entity as a particular type of organization can have significant tax consequences. Determining the best structure for a taxable subsidiary requires evaluation of several factors, including tax, accounting and regulatory implications.[38] The tax-exempt entity may seek to conduct its activities through a separate partnership, limited liability company ("LLC") or a corporation. In every situation, each legal structure should be evaluated by the tax-exempt entity to determine which best fits the needs of the organization.

Sole Proprietorships:

Some taxable business entities can be organized as sole proprietorships, unincorporated business enterprises owned by an individual. A sole proprietorship is the simplest form of business to maintain and has no existence apart from its owner. It may be as simple to create as filing a DBA ("doing business as") certificate with the appropriate state agency. The liabilities of a sole proprietorship are personal liabilities, and the owner undertakes the risks of the business for all assets owned.[39] Although a sole

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

proprietorship may be simple to form, it is not advantageous because it limits access to capital as there is only one owner. Thus, outside capital can only be obtained through loans, instead of having investors.[40] Moreover, a sole proprietorship is an unattractive choice of entity for a tax-exempt organization because the business activity conducted as a sole proprietorship would be considered an undertaking conducted directly by the exempt organization and thus would serve not serve the purpose of creating a separate legal entity.[41]

Corporations:

Most taxable subsidiaries will take a corporate form, as these are the most common of the business forms. A corporation is a business entity created under state law which acts as an independent entity outside of its shareholders and directors.[42] A corporation is taxed as a separate entity, has its own tax identification number and files its own income tax return. A corporation's shareholders are the owners of the corporation and have limited liability for the debts of the corporation.[43] Thus, subsidiary corporations provide a shield from liability for the tax-exempt parent corporation and enable the exempt parent to control the subsidiary by holding all or at least a majority of the stock. Under certain circumstances the exempt parent can increase access to capital by selling shares of the subsidiary. There are also opportunities to share management and control when there are multiple owners.[44]

C Corporations: As a general rule, a corporation is treated as a "C Corporation" for tax purposes, unless it elects to be treated as an "S Corporation" (as discussed below).[45] C Corporations are the most common structure used by tax-exempt organizations to isolate their unrelated business activities.[46] Unlike "pass-through" entities such as partnerships, limited liability companies and S Corporations, C Corporations are subject to tax on their income. Then, when the after tax earnings are distributed to shareholders in the form of a dividend, the shareholders are generally subject to tax.[47] For most taxpayers this so-called "double tax" is the primary disadvantage of forming a C Corporation. However, in the case of an exempt organization, dividend income is not subject to the tax on unrelated income, thereby making the C Corporation an attractive choice of entity for the taxable subsidiary.[48]

Another advantage of creating a C Corporation is the potential to access the capital markets. Since the C Corporation is not limited in the number of stockholders it may have, a C Corporation can raise capital through private placement and similar private equity offerings, or become a public corporation, whose shares of stock can be bought or sold on an exchange. A C Corporation also allows shareholders to transfer their shares to others and can issue different types of shares, increasing access to equity capital.[49] Thus, by moving a potentially high value asset such as a patent or other marketable intellectual property to a taxable subsidiary, the tax-exempt organization may generate substantial revenues both from dividends and the sale of its subsidiary's stock.

S Corporations: An S Corporation is a corporation for state law requirements but has elected to be taxed under a pass-through system similar to partnerships.[50] Since 1998, tax-exempt organizations have been allowed to be shareholders in S Corporations.[51] The main difference between a C Corporation and an S Corporation is that a C Corporation is subject to Federal income tax on its income, while an S Corporation's items of income, loss, credit and deduction flow through, pro rata, to its shareholders.[52] Unlike a C Corporation, an S Corporation cannot have unlimited shareholders.[53] In order to elect S Corporation status, the corporation must be a domestic corporation and it must <u>not</u> have: (1) more than 100 shareholders; (2) more than one class of stock; (3) any shareholders who are not individuals (other than estates and certain trusts and exempt organizations); and (4) any shareholders who are non-resident aliens.[54]

The S Corporation is exempt from federal income tax except for a tax on certain capital gains and investment income.[55] However, all income of the S Corporation is passed through as unrelated business income to a tax-exempt parent.[56] Although, in general, shareholders of eligible domestic corporations can avoid double taxation (once to the corporation and again to the shareholders) by electing S Corporation status, a tax-exempt organization does not receive this advantage. Thus, an S Corporation may not be a beneficial choice of entity because any interest in the S Corporation is treated as an interest in an unrelated trade or business.[57]

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

The choice of a corporate form may prove to be more complex and may require the more time to create and administer than other entity forms; yet, it may allow for the most extensive pool of investment capital and greatest ease in transferability of ownership.[58] However, both the unrelated business income attribution with an S Corporation and the potential double tax expense of unwinding the C Corporation are disadvantages that should be taken into account when considering either of these forms as the choice of entity for a taxable subsidiary.

Partnerships

An unincorporated organization with two or more members is generally classified as a partnership for federal tax purposes if its members carry on a trade, business, financial operation, or venture and divide its profits.[59] A partnership is recognized by the courts as a separate legal entity, as is a corporation or a trust, which usually includes a profit motive. A partnership is generally evidenced by a partnership agreement which is entered into between individuals, corporations, and/or other partnerships, who are the partners. Code section 7701(a)(2) defines a partnership as a "syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not….a trust or estate or a corporation."[60]

For tax purposes, the partnership is not a taxable entity, but rather a reporting entity.[61] Thus, the taxable income from a partnership will be reported on each partner's individual income tax return.[62] The primary advantage of structuring a subsidiary as a partnership is that income earned by a partnership flows through to the parent without the need to declare a dividend as in the case of a C Corporation; and, unlike the S Corporation, an exempt organization's interest in a partnership is not de facto treated as an interest in an unrelated trade or business. Instead, income earned by the partnership is considered to be earned directly by the partners. Thus, *only* where the trade or business from which the income is derived by the partnership would be an unrelated trade or business if carried on directly by the exempt organization, will the income from such activity passed through to the tax-exempt partner be subject to UBTI.[63] However, depending on the structure, a partnership could have disadvantages which make it an unattractive choice of entity for a tax exempt organization. Like the sole proprietorship, each of the general partners in a partnership has unlimited personal liability for the obligations of the partnership. Further, it may be difficult to dispose of partnership interests without dissolving the partnership in its entirety.[64]

The exempt organization may also consider creating a subsidiary as a limited partnership, which has the same structure as a general partnership but allows each partner to have partial limited liability.[65] The limited partnership structure limits the exposure of one or more partners to the general obligations of the enterprise. The Model Revised Uniform Limited Partnership Act (RULPA) provides that a limited partnership must have one or more general partners with unlimited liability and one or more limited partners. Typically, a limited partner has limited rights to participate in the management of the partnership and has limited ability to demand distributions. Also, if the partnership substantially complies with the applicable state limited partnership statute, the liability of an exempt limited partner is limited to the amount of capital which that partner contributed. However, acting as a limited partner may not be an attractive option for the exempt organization, even if it owns a majority of the interests in the partnership. For fiduciary and business reasons, the exempt partner may wish to manage the activities of, and control distributions from, the partnership, especially where it has contributed significant assets.

Limited Liability Companies

The Limited Liability Company ("LLC") is a relatively new form of entity which combines the pass-through treatment available from partnerships and S Corporations with the centralized management and free transferability advantages of C Corporations. An LLC is an unincorporated business entity that provides limited liability for members,[66] while allowing active participation in the management of the business and preserving partnership tax status.[67] An LLC is an entity formed under state law by filing articles of organization as an LLC. Legally, an LLC is neither a partnership nor a corporation. Unlike a partnership, none of the members of an LLC is personally liable for its debts. Similar to a corporation, an LLC provides liability protection for its owners while avoiding corporate income tax due to the pass-through of tax items to its owners.[68]

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

An LLC may be classified for federal income tax purposes as a partnership, a corporation, or an entity disregarded as separate from its owner in accordance with the "check-the-box" rules of Regulations Section 301.7701-3.[69] Essentially, the LLC is a hybrid between the corporation and the limited partnership. The LLC protects all members from individual liability for company debts and misdeeds, similar to the protection provided to corporate shareholders. However, members are liable for their agreed contributions.

An LLC may be managed by some or all of its members or by elected managers. A wholly owned LLC may be an advantageous choice of entity to an exempt organization that engages in relatively low-level commercial activities that will not produce unrelated business income. This structure is unlikely to jeopardize the parent organization's tax-exempt status. However, an LLC could present serious tax risks for its parent tax-exempt organization. Generally, single-member LLC's do not provide any beneficial tax consequences for the parent organization because the IRS treats the LLC as an "activity" of the parent and the two incomes are combined for tax purposes. [70] The exempt parent will be required to report as unrelated business taxable income its share of the LLC's earned income, regardless of whether it is distributed to the parent.[71] Therefore, a single member LLC which does not elect to be taxed as a Corporation may not be a beneficial choice of entity for a tax-exempt parent organization because it would not afford a separate tax status.[72]

Table of Choice of Entity Advantages and Disadvantages:[73]

Entity	Sole Proprietorship	General Partnership	"C" Corporation	"S" Corporation	LLC
Limited Liability	No	No	Yes	Yes	Yes
Double Taxation	No	No	Yes	No	No
Easier Transfer of Ownership	No	Yes	Yes	Yes	Yes
Increased Accounting and Reporting Requirements	No	Yes	Yes	Yes	Yes
Ability to Allocate Income and Deductions to Owners	No	Yes	No	No	Yes
Capital Sources other than Borrowing	No	Yes	Yes	Yes	Yes
Losses Pass-thru to Owners	Yes	Yes	No	Yes	Yes
Limited Life	Yes	Yes	No	No	Yes

Joint Ventures:

A joint venture has been defined by courts to be "an association of two or more persons with intent to carry out a single business venture for joint profit, for which purpose they combine their efforts, property, money, skill, and knowledge, but they do so without creating a formal partnership, trust, or corporation."[74] A for-profit joint venture can be a good vehicle for an exempt organization to conduct unrelated business activities, provided (1) the activities of the joint venture further exempt purposes; and (2) the joint venture documents allow the exempt organization to continue furthering its exempt purpose without benefiting the private parties more than incidentally.[75] Exempts considering the joint venture as the form of their enterprise should carefully consider Revenue Ruling 98-15, wherein the IRS specified that the primary indication of whether

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

a for-profit joint venture furthers an organization's exempt purpose is whether the document creating the venture (such as the operating agreement for an LLC) makes the exempt purpose primary to other purposes.[76]

Tax-exempt entities may also participate in so-called "ancillary" joint ventures – ventures where the exempt organization does not contribute all or substantially all of its assets into the for-profit enterprise. In Revenue Ruling 2004-51, 2004-22 I.R.B. 794, a tax exempt university sold a portion of its assets to an LLC in exchange for a fifty percent (50%) interest in the company. The other 50% member was a for-profit corporation that contributed interactive video assets. The LLC's exclusive purpose was to provide teacher training programs using the interactive video assets. Both members shared the same voting control and shared profit and loss equally. With the exception of the selection of technical employees, both members shared management decisions equally. Moreover, the LLC was specifically prohibited from engaging in activities that jeopardized the exempt status of the university. The IRS determined that the university could participate in the joint venture without jeopardizing its exempt status and that the income generated from such participation was not subject to the tax on unrelated business income.[77]

Tax-exempt organizations that engage in joint ventures with a for-profit should comply with the standards set forth in Revenue Ruling 2004-51, as well as Revenue Ruling 98-15. An exempt organization should possess control over a joint venture to ensure that the arrangement does not jeopardize its exempt status.[78] Generally, a tax-exempt organization can enter into a venture or management contract without risking its status, provided it maintains control over the assets it contributes, and if the terms of the contract are reasonable.[79] Control over the assets is very important, and to satisfy this requirement, the organizational documents for ventures involving tax-exempt organizations should contain legally enforceable provisions that vest the exempt organizations with control over the venture.[80]

Joint Ventures Formed by Contract

The structures listed above are legal entities formed by the parties for the purpose of conducting the joint venture. However, under certain circumstances a joint venture may be created by agreement, without the formalities of a filing with the Secretary of State and the creation of a distinct legal entity. For example, in PLR 200610022 (December 12, 2005), the IRS ruled on a venture between an educational organization and a for-profit co-venture created by a "Sale and Joint Publication Agreement". Pursuant to the terms of the agreement, the educational institution sold a one-half interest in a scholarly journal to a publisher (a for-profit organization) in return for a one time payment. The educational organization retained control over the editorial content of the scholarly publication and would receive compensation (in the form of fair market value royalties) for the use of its content. In its ruling, the IRS determined that the agreement between the parties was analogous to a partnership between the educational institution and the publisher and applied the principles of Revenue Ruling 98-15 (discussed above) to determine whether the joint venture would affect the educational organization's tax-exempt status.[81]

IV. POTENTIAL ISSUES AFTER FORMING THE SUBSIDIARY

Corporate Separateness

For Federal income tax purposes, where a subsidiary is organized with a bona fide intention that it will have some real and substantial business function, its existence may not generally be disregarded for tax purposes.[82] However, where the parent-corporation so controls the affairs of the subsidiary that it is merely an instrumentality of the parent, the separate corporate entity of the subsidiary may be disregarded.[83]

Tax-exempt organizations should be careful to ensure the commercial activities of a subsidiary are considered separate activities for purposes of preserving the exempt organization's exempt status under the Code.[84] The parent entity must keep the subsidiary's activities clearly distinguished from its own and observe the requisite formalities. Otherwise, the IRS might "pierce the corporate veil" and treat the subsidiary and the tax-exempt parent as the same organization for tax purposes, which defeats the purpose of forming a taxable subsidiary. The IRS has privately ruled that the law is as follows: "The activities of a separately incorporated subsidiary cannot ordinarily be attributed to its parent organization unless the facts provide clear and convincing evidence that the subsidiary is in reality an arm, agent or integral part of the parent."[85]

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

Governance

The IRS has provided some guidance for tax-exempt organizations creating for-profit subsidiaries who seek to establish the required "separateness" between the entities. In Private Letter Ruling 9542045, the IRS determined that a tax-exempt organization formed two legally separate subsidiaries that had real and substantial business functions and whose existence would not be disregarded for tax purposes.[86] For an interim period of time (no longer than six months from the transfer of assets from the parent to the subsidiary), the officers of the parent were also the officers of the subsidiary.[87] A majority of the board members of the subsidiary were independent of the parent organization, including the CEO and President.[88] The management of the parent company represented that there was no understanding or agreement, written or unwritten, that the parent would direct or actively participate in the day-to-day management of the subsidiary; the parent would only exercise the normal rights of a shareholder. The exempt parent executed a written services agreement for the leasing of property to the subsidiaries, and the subsidiary corporations kept detailed records reflecting the actual usage of space, equipment, and services, for which the subsidiaries reimbursed the parent. In reviewing all of these facts, the IRS concluded that the activities of the subsidiary corporations should not be attributed to the parent, and their corporate separateness should be recognized.[89]

In Private Letter Ruling 199938041, the IRS set forth a blueprint for a non-profit to create a taxable subsidiary. Apparently, the key to securing IRS respect of corporate separateness is maintaining formal independence of the parent and the subsidiary. The elements of separation include:

1) A majority of the Board of Directors of the subsidiary cannot be current officers or directors of the exempt parent, however, the executive director of the parent (or CEO) can serve on the subsidiary's board and its executive committee. Further, the parent can not directly or actively participate in the day-to-day management of the subsidiary.

2) To the extent that the subsidiary may lease office space from the parent, detailed records should be maintained reflecting the actual usage, and the subsidiary should reimburse the parent for such usage. Similarly, if the parent were to provide administrative services to the subsidiary, the subsidiary should pay compensation or provide sufficient reimbursement for such services.

3) The parent may provide all the initial capitalization of the subsidiary and provide a no-fee license of its mailing list without resulting in unrelated business taxable income.

4) The exempt parent may furnish intellectual property to the subsidiary as a capital contribution.

Similarly, in General Counsel Memorandum (GCM) 39,326, an exempt organization formed several taxable subsidiaries, each having a bona fide business purpose.[90] In concluding that the structure of each of the subsidiaries was sufficient to ensure that the tax-exempt status of the parent was secure and the subsidiaries were not mere arms or instrumentalities of the parent, the GCM noted the following characteristics of the arrangement between the parent and the subsidiaries: (1) for each subsidiary, the parent organization was the sole shareholder and appointed all of the members of subsidiary's board of directors; (2) a majority of the boards of directors of the subsidiaries was not shared with the parent; (3) the CEO of each subsidiary was neither a board member nor an officer of the parent; and (4) the parent did not participate in the day-to-day activities of the subsidiaries.

The observance of corporate formalities is also important for an exempt organization to maintain corporate separateness from its taxable subsidiary. The subsidiary should have a separate bank account, keep separate records from the parent, and should also have regular board meetings and keep minutes.[91] It is also recommended that the subsidiary have its own tax identification number and file separate tax returns from the exempt parent organization.[92] If the subsidiary is not recognized by the IRS for its corporate separateness, the tax consequences are that the two organizations are treated as one. If the taxable subsidiary conducts an unrelated trade or business, the tax-exempt

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

parent will be subject to the unrelated business income tax on this income. In addition, if the activities of the subsidiary become too substantial, the tax-exempt parent may jeopardize or even lose its exempt status. Therefore, it is vitally important for an exempt organization to understand all the steps that must be taken to ensure corporate separateness between the parent organization and the subsidiary.

Private Inurement and Private Benefit Rules

Within the Code, there are several requirements that an exempt parent and its subsidiary deal with each other at arm's length.[93] Many of the subsections of Code Section 501(c) contain an implied, if not express, requirement that no part of the net earnings of an exempt organization inure to the benefit of "private shareholders" or individuals.[94] The private benefit rules provide that the exempt parent must receive fair market value for all the assets conferred onto the subsidiary and any services rendered to the subsidiary. In addition, the transfer pricing rules of Code Section 482 can be used by the IRS to reallocate income received from arrangements between the parent and its subsidiary that are "out of market."[95]

Control

For any exempt organization considering the formation of a taxable subsidiary, the issue of control should play a substantial role in determining the structure of the subsidiary. Generally, amounts paid as dividends from the taxable subsidiary to the exempt parent are not taxable to the parent organization.[96] However, Section 512(b)(13) of the Code provides special rules regarding certain other passive income derived by an exempt organization from a controlled subsidiary, and generally treats otherwise excluded rents, royalties, annuities, and interest as unrelated business income if such income is received from a taxable organization or tax-exempt subsidiary that is 50 percent controlled by the parent tax-exempt organization.[97] A parent organization is deemed to "control" any corporate subsidiary in which it holds over 50 percent of the voting power, either directly or indirectly. In the case of a partnership (or an LLC treated as a partnership for tax purposes), control is determined on the basis of the exempt organization's interest in capital or profits.[98] Interest, rent, annuity, or royalty payments made by a controlled entity to the tax-exempt organization are included as income for purpose of the unrelated business income tax to the extent the payment reduces the net income of the controlled entity.[99] Any exempt parent should be cautious of this rule when deciding how much control they wish to maintain over the taxable subsidiary.

V. CONCLUSION

There are various reasons an exempt organization may form a taxable subsidiary, including, but not limited to, protecting its tax exempt status, increasing liability protection, minimizing state and local tax liability, leveraging assets, centralizing management efficiencies and creating flexibility in compensation. Because of these reasons, it may prove advantageous for an exempt organization to form a taxable subsidiary. Once the decision is made to form a subsidiary, the choice of entity should be analyzed giving consideration to the needs of the organization as well as the motivations behind the subsidiary's formation. Once created, careful consideration should be given to ensuring that the subsidiary maintains the requisite separateness from the parent exempt organization, has proper governance, and remains vigilant with respect to the IRS private inurement and private benefit rules.

---

[1] The author would like to thank Catherine Hammer, Georgia State University, College of Law, for her enthusiastic research and patient proofing.
[2] I.R.C. § 501(c)(3).
[3] Tax Analysts, Tax Notes Today, *Finance Committee Issues Report on the Nature Conservancy*, 2005 TNT 109-11 [Part 1 of 2] (June 8, 2005).
[4] Net Income is defined as gross income less any allowable deductions that are directly connected with the carrying on of the unrelated trade or business by Treas. Reg. § 1.512(a)-1(a).
[5] Treas. Reg. § 1.512(b)-(c).
[6] *See* I.R.S. Priv. Ltr. Rul. 200130048 (April 19, 2001).
[7] *See, e.g.* Treas. Reg. § 1.501(c)(3)-1(e).
[8] *See* Orange County Agric. Soc'y, Inc. v. Comm'r, 893 F.2d 529, 533-34 (2d Cir. 1990).
[9] *See* Better Bus. Bureau v. United States, 326 U.S. 279 (1945).
[10] *See* J. Patrick Plunkett & Heidi Neff Christianson, *The Quest for Cash: Exempt Organizations, Joint Ventures, Taxable Subsidiaries, & Unrelated Business Income*, 31 WM. MITCHELL L. REV 1 (2004). [hereinafter Plunkett, Exempt Organizations].
[11] Internal Revenue Service, Exempt Organizations Examination Guidelines Handbook, 17 7.8.1.1.7 Unrelated Business Income (1999).
[12] Plunkett & Christianson, *supra* note 9.
[13] Brad Caftel, *Legal Structure Issues in the Development of Business Ventures*, THE NATIONAL ECONOMIC DEVELOPMENT & LAW CENTER (Apr. 2002) [hereinafter NEDLC].
[14] *See* I.R.S. Priv. Ltr. Rul. 200225046 (March 28, 2002).
[15] *See* "Corporate Separateness" *infra* section III of this memo.
[16] *See* NEDLC *supra* note 12.
[17] *Id.*
[18] Treas. Reg. § 1.501(c)(3)-1(d)(5)(iv)(b).
[19] *See* I.R.S. Priv. Ltr. Rul. 200434028 (May 25, 2004).
[20] *See* Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).

[21] *See* Scholastic Book Clubs, Inc. v. State, Dept. of Treasury, Revenue Div., 233 Mich. App. 576, 567, 567 N.W. 2d 692 (1997), appeal denied, 457 Mich. 879, 586 N.W. 2d 923 (1998).
[22] *See* Florida Dept. of Revenue v. Share Intern, Inc., 667 So. 2d 226 (Fla. Dist. Ct. App. 1st Dist. 1995).
[23] *See* Dept. of Revenue v. Share Intern., Inc., 676 So. 2d 1362 (Fla. 1996), cert. denied, 591 U.S. 1056 (1997).
[24] Legal Structures for Business Ventures by Brad Caftel, http://www.tgci.com/magazine/97winter/legal4.asp (last visited Aug. 1, 2006).
[25] Adopto Consumer Guides, http://www.venture-capital.adopto-finance.com/glossary.html (last visited Aug.1, 2006).
[26] Caftel, *supra* note 18.
[27] Eugene Steuerle, *When Nonprofits conduct Exempt Activities as Taxable Enterprises*, URBAN INSTITUTE (May 1, 2000) *available at* http://www.urban.org/url.cfm?ID=310254.
[28] *See* I.R.S. Priv. Ltr. Rul. 200225046 (Mar. 26, 2002).
[29] I.R.C. § 162.
[30] I.R.C. § 4958.
[31] I.R.C. § 4958(c)(1)(A).
[32] A disqualified person means (1) any person who was, at any time during the five year period ending on the date of the transaction involved, in a position to exercise substantial influence over the affairs of the organization (whether by virtue of being an organization manager or otherwise), (2) a member of the family of an individual described in the preceding category and (3) an entity in which individuals described in the preceding two categories own more than a 35 percent interest. IRC § 4958(F)(1)(A)-(C).
[33] Sec. 4958(F)(1)(A); Treas. Reg. 53.4958(a)
[34] Reg. § 53.4958-4(b)(1)(ii)(A)
[35] I.R.C. § 4958 (2004); Treas. Reg. § 53.4958-1 (as amended in 2002)
[36] See I.R.S. Priv. Ltr. Rul. 90-16-072 (Apr. 20, 1990).
[37] *Id.*
[38] Sherri D. Way, *Taxable Subsidiaries and the Tax-Exempt Entities Who Love Them*, COLORADO LAWYER (2002).
[39] Internal Revenue Service, Sole Proprietorship, http://www.irs.gov/businesses/small/article/0,,id=98202,00.html (last visited August 1, 2006).
[40] Martha Doran, G.E. Whittenburg, & Radie G. Bunn, *Limited Liability Company: Still the Best Choice for Most Small Businesses*, 21 J. TAX'N INV. 392 (2004) [hereinafter Doran, Limited Liability Company].
[41] BRUCE R. HOPKINS, THE LAW OF TAX EXEMPT ORGANIZATIONS 919 (John Wiley & Sons, Inc. 2003).
[42] I.R.C. § 1361(a)(2)
[43] *Id.*
[44]Types of Entities, http://www.pcms-team.com/inc/types.php (last visited Aug. 1, 2006).
[45] Pursuant to the "check-the-box" Regulations, an entity may elect its tax treatment. However, organizations created as "corporations" under state law are per se corporations for tax purposes. Treas. Reg. §301.7701-2(b).
[46] Sherri D. Way, *Taxable Subsidiaries and the Tax-Exempt Entities Who Love Them*, COLORADO LAWYER (2002).
[47] C Corporation *supra* note 39.
[48] I.R.C. § 512(b)(1).
[49] *See* Doran, Limited Liability Company *supra* note 37.
[50] I.R.C. § 1366.
[51] I.R.C. § 1361(c)(6).
[52] I.R.C. § 1366.
[53] I.R.C. § 1361(b)(1).
[54] I.R.C. § 1361(b)(1).
[55] I.R.C. § 1374.
[56] I.R.C. § 512(e)(i)(B).
[57] I.R.C. § 512(e)(1)(A).
[58] *See* Doran, Limited Liability Company *supra* note 37.
[59] Internal Revenue Service, Forming a Partnership, http://www.irs.gov/publications/p541/ar02.html#d0e209 (last visited Aug. 1, 2006).
[60] I.R.C. § 7701(a)(2).
[61] *I.R.C. § 701*
[62] *Id.*
[63] I.R.C. § 512(c)(1).
[64] *See* Doran, Limited Liability Company *supra* note 37
[65] Revised Uniform Limited Partnership Act of 2001, § 303, *available at* http://www.law.upenn.edu/bll/ulc/ulpa/final2001.htm.
[66] The owners of an LLC are referred to as "members."
[67] *See* Emily A. Lackey, *Piercing the Veil of Limited Liability in the Non-Corporate Setting*, 55 ARK. L. REV. 553 (2002).
[68] *See* NEDLC *supra* note 12.
[69] *See* Internal Revenue Service *supra* note 62.
[70] *See* I.R.S. Priv. Ltr. Rul. 200134025 (May 22, 2001).
[71] *See* I.R.C. § 512(c).
[72] *See* Treas. Reg. 301.7701-3(b).
[73] *See* Doran, Limited Liability Company *supra* note 37.
[74] Whiteford v. United States, 61-1 U.S.Tax Cas. (CCH) ¶ 9301, at 79,762 (1960).
[75] Rev. Rul. 98-15, 1998-12 I.R.B.
[76] *See* Rev. Rul. 98-15 *supra* note 57.
[77] Rev. Rul. 2004-51, 2004-22, I.R.B. 794.
[78] *Id.*
[79] IRS Exempt Organizations Continuing Professional Education Text for FY 1999: *Chapter* A, Whole Hospital Joint Ventures, 98 TAX NOTES TODAY 156-15, Aug. 13, 1998, and P 49.
[80] Rev. Rul. 98-15, 1998-12 I.R.B. 6,9.
[81] I.R.S. Priv. Ltr. Rul. 200610022 (Dec. 6, 2002)
[82] Britt v. United States, 431 F.2d 227, 234 (5th Cir. 1970).
[83] *See generally*, National Carbide Corp. v. Comm'r, 336 U.S. 422, 437 (1949); Krivo Indus. Supply Co. v. Nat'l Distillers & Chemical Corp., 483 F.2d 1098 (5th Cir. 1973).
[84] I.R.S. Priv. Ltr. Rul. 95-42-045 (July 28, 1995).
[85] I.R.S. Priv. Ltr. Rul. 02-13-2040 (Mar. 28, 2002).
[86] I.R.S. Priv. Ltr. Rul. 95-42-045 (July 28, 1995).
[87] *Id.*
[88] *Id.*
[89] *Id.*
[90] I.R.S. Gen. Couns. Mem. 39,326 (Jan. 17, 1985).
[91] Suzanne Ross McDowell and Joseph E. Lundy, *The Use of For-Profit Subsidiaries by Exempt Organizations*, AMERICAN BAR ASSOCIATION – SECTION OF TAXATION (2003).
[92] *See* Plunkett, Exempt Organizations, *supra* note 9.
[93] *The Use of For-Profit Subsidiaries by Exempt Organizations*, AMERICAN BAR ASSOCIATION – SECTION OF TAXATION (2003).
[94] I.R.C. § § 501(c)(3), (4), (6),(7), (9), (10), (11), (13), and (19).
[95] I.R.C. § 482.
[96] I.R.C. § 512(b)(1).
[97] The Taxpayer Relief Act of 1997 instituted major amendments to section 512(b)(13), including lowering the definition of "control" from 80% to 50%. I.R.C. § 512(b)(13)(D).
[98] I.R.C. § 512(b)(13)(D)(i)(II).
[99] I.R.C. § 512(b)(13)(A).

This material is protected by copyright. Copyright © 2006 various authors and the Association of Corporate Counsel (ACC).