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

October 6, 2011
12:00 – 2:00 p.m. EDT

Venable LLP
575 7th Street, NW
Washington, DC 20004

Moderator:
Jeffrey S. Tenenbaum, Esq.

Panelists:
Lisa M. Hix, Esq.
Audra J. Heagney, Esq.
George Sifakis

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Presentations

Nonprofit Strategic Partnerships

Building Successful Ones and Avoiding the Legal Traps



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Strategic Partnership Defined

- ❖ Strategic partnerships are formal alliances between two commercial enterprises usually formalized by business contracts
- ❖ Usually falls short of forming a legal partnership, agency or corporate affiliate relationship



Source: Wikipedia

Forming Long-Term Strategic Partnerships

Three Key Elements:

1. **Ethos** 2. Growth 3. Due Diligence

- The disposition, character, or fundamental values peculiar to a specific person, people, culture, or movement.
- Do the partners share a common ethos?
- “The general ethos of the people have to govern determines the behavior of politicians.” -T.S. Eliot

Source: Wikipedia

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Forming Long-Term Strategic Partnerships

Three Key Elements:

1. Ethos **2. Growth** 3. Due Diligence

- How will the partnership serve as a catalyst for growth of each organization?



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Forming Long-Term Strategic Partnerships

Three Key Elements:

1. Ethos 2. Growth **3. Due Diligence**



- Establish a matrix to ensure the partners share the vision

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Clinton Global Initiative as Strategic Partnership Catalyst

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Case Study - Clinton Global Initiative - Community Technology Access Project

Source: UNHCR.org

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The Clinton Global Initiative



- ✦ Microsoft and EDP, Portugal's largest energy company meet with the Clinton Global Initiative to provide refugees in 11 countries computer access.
- ✦ Program will help counter the rapid depletion of natural resources and create lasting personal and social benefits.

Source: UNHCR.org

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The Clinton Global Initiative



- + “We believe that providing access to technology, particularly in remote areas, can help restore some of the stability these people had known as well as providing crucial access to education and livelihood opportunities, in particular for refugee women and girls.”
-UN High Commissioner Antonio Guterres

Source: UNHCR.org

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Potential Partnerships

- When looking for a partnership, consider checking with professional and industry organizations, professional service providers, and parallel businesses in your industry.



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Potential Partnerships



- Even direct competitors can establish a noncompetitive relationship, pooling resources and ideas that help each other.

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Potential Partnerships

- All potential strategic partners will have the same vision and drive to make the partnership successful. **Wrong.**
- It is vital to obtain references and perspective from individuals who know the target partner organization.

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Potential Partnerships

- Once you've identified a possible partner it's also wise to ask yourself the hard questions:
 - Does this organization seem like a good fit?
 - Are its people the best at what they do?
 - Could I get someone even better?



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Potential Partnerships



- Don't sell yourself short. If you do, you're going to be spending a lot of time and energy holding up your end of the relationship. Source: inc.com

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Potential Partnerships

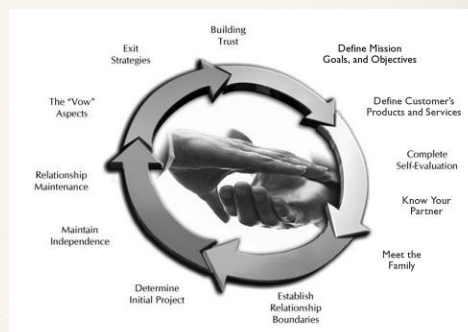
- If you have a big-name strategic partner that doesn't live up to promises, you may find yourself in a bind. Take time to make sure you are choosing wisely.



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The Strategic Partnership Model

- ❖ **Building Trust**
- ❖ Recognize differences that can be categorized by class, culture, gender, race, ethnicity, geography that may pose as challenges in building trust so that you are better prepared to overcome common misperceptions



Source: Strategic Partnership by Robert L. Wallace

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The Strategic Partnership Model



- ✦ **Defining mission, goals and objectives**
- ✦ Bringing a team together successfully requires that each potential alliance member understands completely your mission, goals and objectives

Source: Strategic Partnership by Robert L. Wallace

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The Strategic Partnership Model

- ✦ **Define customers, products and services**
- ✦ Recognize differences between your customers and your partners in order to maximize efficiency and profit



Source: Strategic Partnership by Robert L. Wallace

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The Strategic Partnership Model



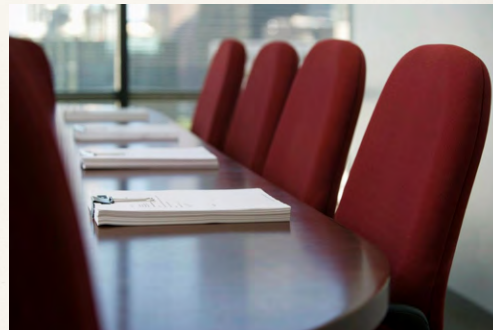
- ❖ **Know your partner**
- ❖ You could be putting yourself and your company on the line by aligning with a wrong firm. Take the time to get to know your potential partners to protect yourself and your business

Source: Strategic Partnership by Robert L. Wallace

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The Strategic Partnership Model

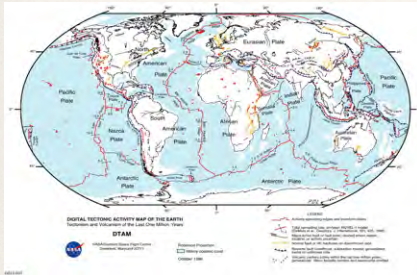
- ❖ **Meet the parents**
- ❖ Get to know any person, organization or institution that directly or indirectly interfaces with the company with which you are proposing to create an alliance



Source: Strategic Partnership by Robert L. Wallace

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The Strategic Partnership Model



- ❖ **Establishing relationship boundaries**
- ❖ Determine up front what your process will be for resolving the conflicts that inevitably arise in any partnership
- ❖ This discussion will allow any problems that arise to be ironed out quickly

Source: Strategic Partnership by Robert L. Wallace 21

The Strategic Partnership Model

- ❖ **Determine first-step project**
- ❖ Be clear about things like the project plan, timeline, performance measures and financial commitments before moving forward



Source: Strategic Partnership by Robert L. Wallace

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The Strategic Partnership Model



- ❖ **Maintain independence**
- ❖ Be clear about what assets are part of the deal and which are not in order to avoid misunderstandings and maintain leverage for the future

Source: Strategic Partnership by Robert L. Wallace

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The Strategic Partnership Model

- ❖ **Relationship maintenance**
- ❖ If your business isn't growing, then its dying
- ❖ Continually take the temperature of the relationship to make sure that everything is well



Source: Strategic Partnership by Robert L. Wallace

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The Strategic Partnership Model



❖ Exit Strategies

- ❖ How will you bring the relationship to a close in such a way that all parties involved feel good about the experience and that they are walking away a better company than before the engaged in the alliance?
- ❖ Must be determined from the start so that there are no misunderstandings

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

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Overview & Introduction



Overview

- **Joint Activities**
 - Joint Programs – By Contract
 - Subsidiary Entities – More Complex
 - LLCs
 - Corporations

- **Promotional and Fundraising Affiliations**
 - Corporate Sponsorships
 - Licensing (Passive Royalty Income)



Need Drives Structure

- **Permanence/Up Start**

- **Desired Flexibility**
 - Capitalization
 - Recruiting and Pay
 - Ability to Participate in Joint Ventures

- **Type of Activity**
 - Liability
 - Tax-Exempt Status



Taxable Activities, Liability & Attribution

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

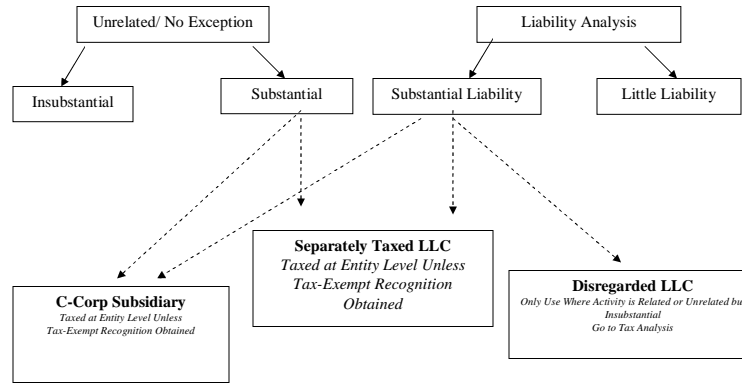


Liability – Tort, Bankruptcy, Etc.

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



Managing Activities and Program Liabilities



Options



Choosing a Form

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



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Contract Clauses

- Outline Respective Roles, Rights and Obligations of Partnership in Contract
- Should Include the Following Provisions:
 - Scope
 - Exclusivity
 - Ownership of IP
 - Allocation of Risks/Indemnification
 - Financial Losses
 - Legal Claims
 - Can Be Difficult to Apportion Responsibility as Contemplated by Typical Indemnity
 - Allocation of Costs
 - Contracts
 - Financial Contributions
 - Distribution of Profits



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Managing Liability Related & Insubstantial Activities

Disregarded LLC

- Single Member, Considered Branch or Division of Member for Tax Purposes
- Shield From Liability (Legal, Not Tax)
- Exempt from Federal Income Tax under Parent's Tax-Exempt Determination Letter
- All Activities, Income and Expenses Report on Form 990
 - Taxation Dependent on Activity Analysis
- If Activities of Disregarded LLC Are Unrelated and Substantial, Could Jeopardize Tax-Exempt Status



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Managing Liability & Taxation

- Separately Taxed LLC
 - Rights and Roles Outlined in Operating Agreement
 - Treated as a Corporation for Tax Purposes
 - Activities Not Attributed to Parent
- C-Corporation
 - Rights and Roles Outlined in Operating Agreement
 - More Formal
 - Can Issue Stock



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Limited Liability Company

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



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Separate LLCs and Corporations

- Can Be Tax-Exempt or For Profit
- May Be Controlled by Exempt Organization
- Legal - Complete Protection from Legal Liability (Beware of “Mere Instrumentality” and Corporate “Piercing”)
- Tax - Activities Not Attributed to Parent; Important Where Activities Are Unrelated
- Choice Between LLC & C-Corp. Depends on Needs of Entity



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Control



Financial Considerations

- **PLRs** – Suggest Limits on Assets which May Be Transferred to a For-Profit Entity

- **Prudent Investor**
 - Director Review
 - Rate of Return



Tax-Exempt Status

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

- Ancillary Joint Venture” – Portion of Resources Are Contributed



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Tax-Exempt Status

- Control over Tax-Exempt Aspects of the Joint Venture

- Voting and Ownership Interests in the Joint Venture that Are Consistent with Capital Contributions

- Joint Venture Gives Priority to the Tax-Exempt's Purposes over Maximization of Profit for Participants in the Joint Venture

- Prohibition on Activities that Would Jeopardize the Tax-Exempt Owner's Tax-Exempt Status



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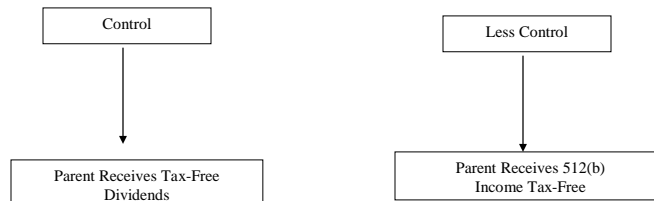
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Methods of Control

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



Tax Implications for Parent Taxable Subsidiaries



Slippery Slope of Control

An Entity Is a Controlled Organization if the Controlling Organization Owns:

- By **Vote or Value More than 50 Percent of a Corporation's Stock** (for an Organization that Is a Corporation) or **Beneficial Interest** (for an Organization that Is an LLC)

Control of a **Nonstock Corporation Means at Least 50 percent of the Directors or Trustees of Such Organization Are Either Representatives of, or Directly or Indirectly Controlled by, the Controlling Organization**



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Tax Implications for Separate Entity

- Tax-Exempt Activities Require **Separate Tax-Exempt Determination** to Avoid Taxation
 - But Can **Bifurcate** Activities
- Corporation Is Treated as a **Separate Taxpayer**, Subject to Corporate Income Tax at a Maximum Rate of 35%



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Tax Implications for Parent

- If Not Controlled, IRC Section 512(b) Distributions Will Not Result in UBIT to Parent
 1. Dividends (from Stock)
 2. Interest (Typically from Extended Credit)
 3. Royalties (Intellectual Property License)
 4. Rent (Such as Rented Space)

But if a Subsidiary Is Controlled, 2-4 (Excluding Dividends) Do Not Apply



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Net Unrelated Income Excess Benefits

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



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Attribution and Corporate Piercing

- **Separateness**
 - Shared Staffing, but Separate Tracking
 - Financial Separation

- **Corporate Formalities Important**
 - Regular Meetings
 - Documentation



Fundraising and Promotional Affiliations



Corporate Partnerships Maximizing Income

Qualified Sponsorship Payments

- Payment with No Expectation of Substantial Return Benefit
- Disregarded Benefits:
 - Goods or Services, or Other Benefits, the Total Value of Which Does Not Exceed **Two Percent** of the Sponsorship Payment; and
 - **Recognition**, *i.e.*, Use or Acknowledgment of the Sponsor's Name, Logo, or Product Lines in Connection With the Nonprofit's Activities
- Payments Received for **Advertising** Are Characterized as **UBI**



Licensing Arrangements

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



Commercial Co-Ventures

- **Commercial Co-Venture (“CCV”)** – Arrangement Between a Charity and a Commercial Entity under which the Commercial Entity Advertises in a Sales or Marketing Campaign that the Purchase or Use of its Goods or Services Will Benefit a Charity or Charitable Purpose
- For-Profit Business Uses Name and/or Logo of Charity for Purposes of Increasing Sales of Business’s Products or Services and Increasing Revenue to Charity
- Frequently Referred to as “Charitable Sales Promotions” or “Cause-Related Marketing”
- Excellent Fundraising and Marketing Mechanism for both the Charity and Commercial Co-Venturer



Regulation of Commercial Co-Ventures: State Law

- More than 40 States Have Laws Regulating Various Methods of Fundraising, Including Charitable Solicitations and CCVs
- About 20 States Have Laws Specifically Regulating CCVs
- New York Definition of “Commercial Co-Venturer” is Fairly Standard:
 - “Any person who for profit is regularly and primarily engaged in trade or commerce other than in connection with the raising of funds or any other thing of value for a charitable organization and who advertises that the purchase of goods, services, entertainment, or any other thing of value will benefit a charitable organization.” [N.Y. Exec. Laws § 171-a]



Regulation of Commercial Co-Ventures: State Law

- State Law Requirements, Generally:
 - *Registration*
 - *Bonding*
 - *Written Contract*
 - *Advertising Disclosures*
 - *Accounting and Recordkeeping*
- **Registration** – Several States Require Advance Registration by Co-Venturer, Including AL, HI, IL, MA, ME and SC
- **Bonding** – A Few States, Including AL, MA and ME, Require the Co-Venturer to Obtain a Surety Bond



Regulation of Commercial Co-Ventures: State Law

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



Regulation of Commercial Co-Ventures: State Law

- **Co-Venturer Obligations** – States Generally Impose Requirements on the Commercial Co-Venturer Only
- **Charity Obligations** –
 - A Few States Impose Certain CCV Requirements (Filing of Notice, Contract and Accounting) on the Charity
 - Charities Should Be Registered to Solicit Funds Under Charitable Solicitation Laws in States where Sales Promotion Will Run
- Requirements Vary by State. Check the Statute.



Regulation of Commercial Co-Ventures: BBB Standards

- BBB Wise Giving Alliance Standards for Charity Accountability – www.bbb.org/us/charity-standards
- **BBB Standard 19**
 - Should Clearly Disclose How Charity Benefits from the Sales Promotion
 - Ensure That Sales Promotions Disclose the Following at the Point of Solicitation:
 - Actual or anticipated portion of the purchase price that will benefit the charity (e.g., 5 cents will be contributed to ABC charity for every XYZ company product sold);
 - Duration of the campaign; and
 - Any maximum or guaranteed minimum contribution amount (e.g., up to a maximum of \$200,000).



Questions and Discussion

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Jeffrey Tenenbaum chairs Venable's Nonprofit Organizations Practice Group. He is one of the nation's leading nonprofit attorneys, and also is an accomplished author, lecturer and commentator on nonprofit legal matters. Based in the firm's Washington, D.C. office, Mr. Tenenbaum counsels his clients on the broad array of legal issues affecting trade and professional associations, charities, foundations, think tanks, credit and housing counseling agencies, advocacy groups, and other nonprofit organizations, and regularly represents clients before Congress, federal and state regulatory agencies, and in connection with governmental investigations, enforcement actions, litigation, and in dealing with the media.

Mr. Tenenbaum was the 2006 recipient of the American Bar Association's Outstanding Nonprofit Lawyer of the Year Award, the inaugural (2004) recipient of the *Washington Business Journal's* Top Washington Lawyers Award, the 2004 recipient of The Center for Association Leadership's Chairman's Award, and the 1997 recipient of the Greater Washington Society of Association Executives' Chairman's Award. He also was a 2008-09 Fellow of the Bar Association of the District of Columbia and is AV Peer-Review Rated by *Martindale-Hubbell*. He started his career in the nonprofit community by serving as Legal Section manager at the American Society of Association Executives, following several years working on Capitol Hill.

REPRESENTATIVE CLIENTS

AARP
 American Academy of Physician Assistants
 American Association for the Advancement of Science
 American Association of Museums
 American College of Radiology
 American Institute of Architects
 Air Conditioning Contractors of America
 American Society for Microbiology
 American Society for Training and Development
 American Society of Anesthesiologists
 American Society of Association Executives
 American Society of Civil Engineers
 American Society of Clinical Oncology
 American Staffing Association
 Association for Healthcare Philanthropy
 Association of Corporate Counsel
 Association of Private Sector Colleges and Universities
 Automotive Aftermarket Industry Association
 The College Board
 Council on Foundations
 Cruise Lines International Association
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J.D., Catholic University of America, Columbus School of Law, 1996

B.A., Political Science, University of Pennsylvania, 1990

MEMBERSHIPS

American Society of Association Executives

California Society of Association Executives

New York Society of Association Executives

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The Humane Society of the United States
Independent Insurance Agents and Brokers of America
LeadingAge
Lions Club International
Money Management International
National Association of Chain Drug Stores
National Athletic Trainers' Association
National Coalition for Cancer Survivorship
National Defense Industrial Association
National Fallen Firefighters Foundation
National Hot Rod Association
National Propane Gas Association
National Retail Federation
National Student Clearinghouse
National Telecommunications Cooperative Association
The Nature Conservancy
NeighborWorks America
New York Blood Center
Peterson Institute for International Economics
Professional Liability Underwriting Society
Project Management Institute
Public Health Accreditation Board
Public Relations Society of America
Recording Industry Association of America
Romance Writers of America
Texas Association of School Boards
Trust for Architectural Easements
Volunteers of America

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Fellow, Bar Association of the District of Columbia, 2008-09

Recipient, American Bar Association Outstanding Nonprofit Lawyer of the Year Award, 2006

Recipient, *Washington Business Journal* Top Washington Lawyers Award, 2004

Recipient, The Center for Association Leadership Chairman's Award, 2004

Recipient, Greater Washington Society of Association Executives Chairman's Award, 1997

Legal Section Manager / Government Affairs Issues Analyst, American Society of Association Executives, 1993-95

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Listed in *Who's Who in American Law* and *Who's Who in America*, 2005-present editions

ACTIVITIES

Mr. Tenenbaum is an active participant in the nonprofit community who currently serves on the Editorial Advisory Board of the American Society of Association Executives' *Association Law & Policy* legal journal, the Advisory Panel of Wiley/Jossey-Bass' *Nonprofit Business Advisor* newsletter, and the ASAE Public Policy Committee. He previously served as Chairman of the *AL&P* Editorial Advisory Board and has served on the ASAE Legal Section Council, the ASAE Association Management Company Accreditation Commission, the GWSAE Foundation Board of Trustees, the GWSAE Government and Public Affairs Advisory Council, the Federal City Club Foundation Board of Directors, and the Editorial Advisory Board of Aspen's *Nonprofit Tax & Financial Strategies* newsletter.

PUBLICATIONS

Mr. Tenenbaum is the author of the book, *Association Tax Compliance Guide*, published by the American Society of Association Executives, and is a contributor to numerous ASAE books, including *Professional Practices in Association Management*, *Association Law Compendium*, *The Power of Partnership*, *Essentials of the Profession Learning System*, *Generating and Managing Nondues Revenue in Associations*, and several Information Background Kits. He also is a contributor to *Exposed: A Legal Field Guide for Nonprofit Executives*, published by the Nonprofit Risk Management Center. In addition, he is a frequent author for ASAE and many of the other principal nonprofit industry organizations and publications, having written more than 400 articles on nonprofit legal topics.

SPEAKING ENGAGEMENTS

Mr. Tenenbaum is a frequent lecturer for ASAE and many of the major nonprofit industry organizations, conducting over 40 speaking presentations each year, including many with top Internal Revenue Service, Federal Trade Commission, U.S. Department of Justice, Federal Communications Commission, and other federal and government officials. He served on the faculty of the ASAE Virtual Law School, and is a regular commentator on nonprofit legal issues for *The New York Times*, *The Washington Post*, *Los Angeles Times*, *The Washington Times*, *The Baltimore Sun*, *Washington Business Journal*, *Legal Times*, *Association Trends*, *CEO Update*, *Forbes Magazine* and other periodicals. He also has been interviewed on nonprofit legal issues on Voice of America Business Radio and Nonprofit Spark Radio.



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MEMBERSHIPS

Chair, ASAE Legal Symposium
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ASAE Legal Section Council

ASAE Association Law "Tool Kit"
Task Force

ASAE Technology Resources
Committee

Ms. Hix concentrates her practice on counseling charities, trade and professional associations, and other nonprofits on a wide range of legal topics, including tax exemption, intellectual property, corporate governance, and antitrust, among others.

Ms. Hix has broad experience in the nonprofit sector, having served in various capacities at nonprofit organizations, including as the Founding Executive Director of the Memorial Institute for the Prevention of Terrorism (MIPT) and Development Director of East Harlem Block Schools. This experience has included representation before Members of Congress and federal agencies. She also worked in the nonprofit practice of a large national law firm for four years before joining Venable.

PUBLICATIONS

- October 6, 2011, Nonprofit Strategic Partnerships: Building Successful Ones and Avoiding the Legal Traps
- September 20, 2011, Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center and Meeting Contracts
- September 16, 2011, Playing by the Rules: A Fresh Look at Corporate Sponsorship & Affinity Program Income
- August 8, 2011, Cyberspace Risk: The Top Legal Traps for Associations
- June 16, 2011, Sponsorships, Advertising, Endorsements and Cause Marketing: Understanding Critical UBIT Issues for Nonprofits
- May 13, 2011, Online Social Media and Nonprofits: Navigating the Legal Pitfalls
- April 28, 2011, Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center and Meeting Contracts
- April 20, 2011, Navigating Nonprofit Partnerships, Joint Ventures and Commercial Co-Ventures: How Arts Organizations Can Avoid the Legal Pitfalls
- March 29, 2011, Dangers and Opportunities: Navigating Nonprofit Partnerships, Collaborations, Joint Ventures and More
- March 8, 2011, Sponsorships, Advertising, Endorsements, and Cause Marketing - Understanding Critical UBIT Issues for Nonprofits
- February 3, 2011, Top Ten Legal Issues for Associations: Common Mistakes, and How to Avoid Them
- December 16, 2010, So You Want To Be On The Internet[®]
- December 6, 2010, Mergers, Alliances, Affiliations and Acquisitions for Nonprofit Organizations: Financial and Legal Issues
- November 10, 2010, Legal Issues in Publishing – Copyright and Reprint Requests
- November 3, 2010, Cyberspace Risk: What You Don't Know Could Hurt You
- September-October 2010, The Ins and Outs of Alliances and Affiliations,

Associations Now

- September 24, 2010, Doing Business in a Changing Economy: Contracts, Liability, and Understanding Risk
- September 21, 2010, Legal Aspects of Social Networking and Online Media Platforms
- September 20, 2010, Best Practices for Negotiating Meeting Contracts in the Current Economy
- August 24, 2010, Association Alliances, Partnerships and Mergers
- May 7, 2010, Combinations and Alliances Among Nonprofit Associations
- January 26, 2010, The Building Blocks for a Successful Nonprofit Merger
- December 15, 2009, Hotel Contract Clauses That Work: Understanding the Fine Print
- December 15, 2009, Best Practices for Negotiating Hotel Contracts in the Current Economy
- April 16, 2009, Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center, and Meeting Contracts
- March 12, 2009, IM N, R U? Managing the Nonprofit Legalities of Social Networking and Online Media Platforms
- November 18, 2008, The Ten Most Common Online Legal Pitfalls for Nonprofits...and How to Avoid Them
- September 16, 2008, Obtaining and Maintaining Tax-Exemption for Your Affiliates: The Mechanics, Pros and Cons of Group Exemption

SPEAKING ENGAGEMENTS

- October 13, 2011, "Traps on the Web: Legal Essentials on Social Media, Protecting Data, HR Policies & More" for the Better Business Bureau of New York
- October 6, 2011, Nonprofit Strategic Partnerships: Building Successful Ones and Avoiding the Legal Traps
- September 20, 2011, "Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center and Meeting Contracts" at Meeting Quest Charlotte
- September 16, 2011, "Playing by the Rules: A Fresh Look at Corporate Sponsorship & Affinity Program Income" at ASAE's Annual Association Law Symposium
- August 8, 2011, "Cyberspace Risk: The Top Legal Traps for Associations," 2011 ASAE Annual Meeting
- June 16, 2011, Sponsorships, Advertising, Endorsements and Cause Marketing: Understanding Critical UBIT Issues for Nonprofits
- May 18, 2011, "Mastering Tradeshow Contracts" at the 2011 Annual Association Law Symposium in Chicago
- May 17, 2011, "Legal Aspects/Issues of Social Media Platforms" for the Kansas Society of Association Executives
- May 13, 2011, "Cyberspace Risk: The Top Legal Traps for Associations," ASAE Finance, HR & Business Operations Conference
- April 29, 2011 - May 3, 2011, "Trends in Law, Practice and Management of Copyright and Licensing of Content" for the Council of Science Editors
- April 28, 2011, "Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center and Meeting Contracts" at ASAE's 2011 Springtime Expo
- March 29, 2011, "Dangers and Opportunities: Navigating Nonprofit Partnerships, Collaborations, Joint Ventures and More" for Better Business Bureau New York
- March 8, 2011, Legal Quick Hit: "Sponsorships, Advertising, Endorsements, and Cause Marketing - Understanding Critical UBIT Issues for Nonprofits" for the Association of Corporate Counsel's Nonprofit Organizations Committee
- February 7, 2011, "Legal Update: What Every Tax-Exempt Association Should Know" for the Commercial Real Estate Development Association
- February 3, 2011, "Top Legal Issues for Tax-Exempt Associations" for the Mid-Atlantic Society of Association Executives
- December 6, 2010, Mergers, Alliances, Affiliations and Acquisitions for Nonprofit Organizations: Financial and Legal Issues

- November 10, 2010, "Copyright and Reprint Requests" to the Coalition of Education Association Publications
- November 3, 2010, "Cyberspace Risk: What You Don't Know Could Hurt You," Nonprofit Risk Management Center
- September 24, 2010, "Doing Business in a Changing Economy: Contracts, Liability, and Understanding Risk," at the 2010 Annual Association Law Symposium in Washington, DC
- September 21, 2010, "Legal Aspects/Issues of Social Networking and Media Platforms" at the Texas Society of Association Executives Annual Conference
- September 20, 2010, "Best Practices for Negotiating Meeting Contracts in the Current Economy" at the Texas Society of Association Executives Annual Conference
- August 24, 2010, "Association Alliances, Partnerships and Mergers" at the 2010 Annual Meeting & Expo of the American Society of Association Executives (ASAE)
- August 14, 2010, "Overview of Association Law" at the National Institute of Governmental Purchasers Annual Conference
- August 4, 2010, "Avoiding Legal Pitfalls When Using On-Line Social Media" for the Indiana Grantmakers Alliance, in collaboration with various State Grantmakers Alliances
- April 13, 2010, Legal Quick Hit: "Best Practices for Negotiating Hotel Contracts in the Current Economy" for the Association of Corporate Counsel's Nonprofit Organizations Committee
- December 10, 2009, Two presentations on hotel contracts at PMPI's 4th Annual Mid-Atlantic Conference and Expo (MACE)
- September 25, 2009, American Society of Association Executives (ASAE) Annual Association Law Symposium
- June 22, 2009, Building Member and Supporter Buy-In Through Improved Governance Practices
- June 9, 2009, Legal Quick Hit: Copyright Law Basics and Pitfalls for Nonprofits
- April 16, 2009, Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center and Meeting Contracts
- November 18, 2008, Association of Corporate Counsel Webcast: The Ten Most Common Online Legal Pitfalls for Nonprofits ... and How to Avoid Them
- 2008, "Developing Security Policies and Procedures to Protect Member Data" at the 2008 ASAE Association Technology Conference & Expo, Washington, DC
- 2007, "Overtime for Employees on Travel" at the Association of Corporate Counsel "Legal Quick Hit"
- 2007, "Board of Directors' Responsibilities" at the 2007 Society for Women's Health Research Board Orientation, Washington, DC
- 2007, "Legal Considerations in Nonprofit Mergers" at the Association of Corporate Counsel "Legal Quick Hit"
- 2007, "Update on Hotel Contracts: Attrition and Other Key Issues" at the Association of Corporate Counsel "Legal Quick Hit"
- 2007, "Understanding and Managing Fiduciary Responsibility" at the 2007 Finance and Administration Roundtable, Washington, DC
- 2007, "Intellectual Property Challenges in the Life of an Association" at the 2007 ASAE Annual Association Law Symposium, Washington, DC
- 2006, "Contracts Insurance & Liability: What Every Meeting Professional Should Know" at the 2006 ASAE Meetings Management Institute Issues in Hotel Meeting Contracts, ASAE Hotel Operations Program, Washington, DC
- 2006, "Opening General Session Panel: The Year in Review - Legal Style" at the 2006 ASAE Finance & Business Operations Symposium, Baltimore, MD
- 2006, "Legal Issues for Nonprofit Organizations" at the American College of Cardiology, 2006 General Scientific Session, Atlanta, Georgia



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Ms. Heagney is an Associate in Venable's nonprofit organizations and associations practice. She provides counsel to trade and professional associations, charities and foundations, and other nonprofit organizations on a wide variety of legal matters, including tax exemption, lobbying and political activity, regulatory compliance, copyrights and trademarks, certification and accreditation, contracts, and corporate governance, among others. Ms. Heagney regularly assists with the drafting and negotiation of agreements between nonprofits and others. Additionally, she advises clients on all aspects of mergers and other corporate combinations and alliances, including the drafting and negotiating of contracts, conducting due diligence reviews, advising on tax exemption and other legal implications, reconciling bylaws, and effecting the relevant corporate and tax filings. Ms. Heagney also assists with all aspects of tax-exempt organizations, including formation, corporate governance policies and practices, obtaining recognition of tax-exempt status from the IRS, and providing advice on structuring programs and activities to maintain tax exemption and minimize taxable income. Prior to joining Venable, Ms. Heagney worked for five years in the nonprofit organizations practice group of a large national law firm.

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PUBLICATIONS

- October 6, 2011, Nonprofit Strategic Partnerships: Building Successful Ones and Avoiding the Legal Traps
- September 15, 2011, Lobbying: What Does It Mean for Nonprofits?, *Association of Corporate Counsel - Quick Counsel*
- June 2011, Conducting International Operations: Keys for Nonprofits, *Associations Now*
- June 20, 2011, IRS Announces First Round of Revocations for Nonprofits that Failed to File Form 990

SPEAKING ENGAGEMENTS

- November 30, 2011, "Updating your Association RFP and Contract Process - Latest in Association Legal Contract News" for MASAE Annual Conference
- October 6, 2011, Nonprofit Strategic Partnerships: Building Successful Ones and Avoiding the Legal Traps



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Since founding and leading Axela nearly a decade ago, George has crafted countless successful grassroots, legislative, funding and executive communications strategies for Axela clients. George has served in all branches of the Federal Government including as a Presidential Appointee, Senate Committee Staffer at the Committee on Small Business and Docket Clerk at the US Attorney's Office (Boston).

George has successfully coordinated countless initiatives for clients, including coalition/partnerships, grassroots advocacy campaigns, legislative briefings, executive communications and funding blueprint development in coordination with the Axela development and writing team. George is a frequent speaker at national events on client topics, including higher education, healthcare and homeland security. Most recently, George was featured in Parents magazine for a healthy lifestyle feature and was a presenter at the HOSA -Future Health Professionals National Leadership Conference in Anaheim, California.

George supports many philanthropic causes ranging from the First Tee, Aspen Health Steward Coalition, St. George Monastery, Washington Literary Council among many other worthy causes. George is also an alumnus of Suffolk University Graduate School, Rhode Island College, Northeastern University (Paralegal) and Harvard Kennedy School of Government Executive Education.

Arlington, Virginia is home for George and his family, including three young children, George, Alexa and Eva. George is fluent in Greek and enjoys learning how to play golf.

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Additional Information

Articles

May 7, 2010

Combinations and Alliances Among Nonprofit Associations

Related Topic Area(s): Corporate Governance, Meeting, Vendor and Government Contracts, Miscellaneous, Tax and Employee Benefits

There are a wide array of ways in which nonprofit associations can combine, affiliate or otherwise come together. Some involve a complete integration of programs, activities, membership, leadership, and staff, while some provide for maintaining varying degrees of separateness and autonomy. There are pros, cons and considerations to take into account for each option. And sometimes one option can be a stepping stone to a fuller combination. Often the decisions are based on legal, tax or economic concerns, sometimes power and politics will dominate the decisionmaking process, and usually it is a combination of all of these factors.

This article lays out some of the primary means by which nonprofit associations frequently combine, affiliate and otherwise come together in various ways. It explains what they each mean, and also highlights some of the primary considerations that come into play with each option.

I. Merger and Consolidation

A. General

Nonprofit corporations can fully and completely integrate their programs, functions, and membership by merging or consolidating. When two nonprofit entities *merge*, one entity legally becomes part of the surviving entity and dissolves. The surviving corporation takes title to all of the assets, and assumes all of the liabilities, of the non-surviving entity.

Unlike a merger, a *consolidation* of nonprofit entities involves the dissolution of each of the organizations involved, and the creation of an entirely new nonprofit corporation that takes on the programs, resources and membership of the former entities. Although the net effect of a merger and consolidation are the same – one surviving entity with all the assets and liabilities of the two previous groups – many associations prefer consolidation over merger because it tends to lend the perception that no organization has an advantage over the other. There is a new corporation which houses the activities of the two and each is dissolved pursuant to the consolidation.

B. Benefits of Merger or Consolidation

Merger or consolidation of entities with similar exempt purposes may offer a number of benefits to the participating organizations and their members. By merging or consolidating, associations may combine their assets, reduce costs by eliminating redundant administrative processes, and provide broader services and resources to their members. Furthermore, members who paid dues and fees to participate in the formerly separate associations are often able to reduce their membership dues and the costs and time demands of association participation by joining a single, combined organization. Finally, merger or consolidation may allow associations participating within the same field or industry to offer a wider array of educational programming, publications, advocacy and other services to a larger constituency in the public arena.

C. The Divisional Approach

The fact that two organizations have become a unified legal entity does not prohibit them from continuing with some measure of autonomy within the new corporation. Councils or divisions could be established to promote and protect the unique interests of the industry sub-sets. A prominent example of this organizational structure is the American Forest & Paper Association which has a separate Wood Products Council and other councils that represent pulp and paper and other interests. Under this approach, the Articles or Bylaws can cede certain distinct areas of authority to these subordinate bodies. Balancing these levels of authority, finances and management can be

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challenging, but the model is frequently used.

D. Other Considerations

The law imposes stringent fiduciary responsibilities on the members of an organization's governing body to ensure that any merger or consolidation is warranted and in the best interests of the organization. Directors and officers may be held personally and individually liable if they fail to act prudently and with due diligence. Due diligence generally requires an organization's governing body to ascertain the financial and legal condition of the organization with which the entity will be merged or consolidated. This includes examination of the other entity's books and records, governing documents, meeting minutes, pending claims, employment practices, contracts, leases, and insurance policies, and investigation into potentially significant financial obligations, such as the funding of retirement programs, binding commitments to suppliers, and the security of investment vehicles. Boards of directors often utilize accountants and attorneys to conduct due diligence reviews. The opinions of such experts may be relied upon when evaluating a plan of merger, provided that the board of directors establishes a full and accurate financial and legal profile of the other organization before approving the merger or consolidation.

In addition to conducting routine due diligence reviews, an organization's board of directors should have legal counsel review the impact of a proposed merger or consolidation on competition within the industry. Federal antitrust laws prohibit mergers or consolidations that may substantially lessen competition in any line of commerce. The Department of Justice and the Federal Trade Commission may scrutinize any transaction that could lead to price fixing, bid rigging, customer allocation, boycotts, or other anticompetitive practices. That said, mergers and consolidations of nonprofit organizations typically do not pose an anticompetitive threat. If it can be shown that the joining of the two organizations will actually promote competition, there will be very little antitrust risk overall.

As described in more detail below, merger and consolidation are complex processes, which require the approval of the boards of directors and membership, if any, of each organization. As a practical matter, it can be difficult to combine and coordinate the governing bodies, staffs and operations of two or more existing organizations. Additionally, the institutional loyalties of members, officers, and professional staffs often come into play, particularly when the organizations considering merger or consolidation are unequal in size and resources.

E. Procedural Requirements

To merge or consolidate with another organization, each organization must follow the procedures mandated under the nonprofit corporation law of its state of incorporation, as well as any specific procedures in its governing documents, provided such procedures are consistent with the nonprofit corporation statute.

While nonprofit corporation statutes differ by state, the laws governing merger and consolidation of nonprofits typically set forth certain core procedures. The board of directors of each precursor organization must develop and approve a plan of merger or consolidation according to the requirements set forth in the nonprofit corporation statute of the state, or states, where the organizations are incorporated. Typically, the details of the deal between the two organizations are set forth in a "Merger Agreement" that is not required to be filed. This document usually covers items such as integration of the staff and voluntary leadership, corporate governance changes, and programmatic consolidation. It often is quite detailed.

The plan of merger or consolidation also must be submitted to the voting members, if any, of each organization for their approval. While the conditions for member approval vary from state to state, statutes generally require a vote of two-thirds to effectuate the plan merger or consolidation – a number that can be difficult to reach for practical and political reasons. Assuming the members of *both* organizations approve the board's plan, "articles of merger" must be filed in the state where the new entity will be formally incorporated.

Where merging nonprofits are each tax-exempt under different tax classifications (e.g., a 501(c)(3) and a 501(c)(6)), the resulting merged entity will generally need to file a new application for federal tax exemption with the Internal Revenue Service ("IRS"). Likewise, a new, consolidated entity must apply to the IRS for recognition of tax-exempt status. On the other hand, where merging entities share the same tax-exempt classification, the tax-exempt status of the surviving organization is typically not affected. Instead, following the merger, all parties to the transaction must notify the IRS of the merger and provide supporting legal documentation. If the newly merged entity will carry out substantially the

same activities as its predecessors, the IRS will typically grant expedited approval on a *pro forma* basis and there will be no lapse in the tax-exempt status.

II. Acquisition of a Dissolving Corporation's Assets

A. General

Another legal mechanism for "absorption" is the *dissolution and distribution of assets* of a target association. This statutory procedure generally involves the adoption of a plan of dissolution and distribution of assets, satisfaction of outstanding liabilities, transfer of any remaining assets to another nonprofit entity, and dissolution. Where the dissolving nonprofit is exempt under Code Section 501(c)(3), the Treasury Regulations require the organization to distribute its assets for one or more exempt purposes under Code Section 501(c)(3).

B. Benefits and Other Considerations

While the dissolving entity must adhere to specific statutory procedures, a dissolution and transfer of assets is much less onerous on the entity that acquires the dissolving entity's assets (the "successor" entity) than a merger or consolidation. Because the successor entity is merely absorbing the assets of another organization, a vote of the membership and accompanying state filings are typically not required for that corporation. Furthermore, receipt of a dissolving nonprofit corporation's assets typically does not affect an organization's tax-exempt status. However, just as with merger or consolidation, a tax-exempt organization must be cautious when taking on programs or activities to ensure that they support its stated tax-exempt purposes.

Asset transfer and dissolution may be strategically preferable for combining organizations when one organization is of a much smaller size than the other. In addition, this type of transaction is particularly useful when an organization wishes to acquire the assets of another organization with significant future contingent liabilities, because the successor organization does not, by operation of law, assume the liabilities of the dissolving corporation. Further, the successor organization may seek to limit the liabilities it will assume in a written agreement, as discussed below.

While a successor organization is typically shielded from its predecessor's debts and liabilities, an asset transfer always poses some risk of *successor liability*, particularly if adequate provision has not been made for pre-existing liabilities. A court may determine that an organization that acquired the assets of a dissolved corporation impliedly agreed to assume the dissolved corporation's liabilities. Alternatively, a court may find that the successor corporation serves as a "mere continuation" of the dissolved corporation, that the asset transfer amounts to a *de facto* merger, or that the transaction was actually a fraudulent attempt to escape liability. It is also often problematic to extinguish liabilities, such as employee benefit programs, rather than assuming them.

C. Procedural Requirements

Like a merger or consolidation, an asset transfer and dissolution must follow the applicable state nonprofit corporation laws and each entity's governing documents. The procedure for dissolution and asset distribution is fairly simple for the successor entity, as it will simply be entering into a transaction – albeit a significant one – to acquire assets and absorb members, if any. Member approval for such a transaction is typically unnecessary unless the organization's bylaws require otherwise. The due diligence requirements imposed on the successor entity are also less stringent. Nevertheless, the governing body of the successor corporation should conduct a due diligence review of the dissolving corporation as a matter of course, particularly if the acquisition of the dissolving organization's assets will significantly alter the nature of the successor organization's operations.

The process is more complicated, however, for the dissolving entity. In most instances, the nonprofit corporation statute of the dissolving entity's state of incorporation imposes the following requirements to effectuate a transfer and dissolution:

- The governing body of the dissolving corporation is obligated to exercise the same level of due diligence as in a proposed merger or consolidation, as discussed above.
- After the governing body of the dissolving corporation has determined that dissolution and transfer of its assets are in the best interests of the organization, it must develop and approve a "plan of dissolution" (or "plan of distribution" according to some states). The number of directors that must vote to accept the plan varies by state.
- If the dissolving corporation has members, it must obtain member approval of the dissolution plan. Again, the requisite margin of member approval varies from state to state; most states require a

two-thirds majority.

- The dissolving corporation must file “articles of dissolution” with the state in which it is incorporated. States typically accept articles of dissolution only after all remaining debts and liabilities of the dissolving entity are satisfied or provisions for satisfying such debts have been made.
- As part of the plan of dissolution, the dissolving corporation will transfer all of its remaining assets to a designated corporation.
- Once the plan of dissolution is executed, the dissolving entity is generally prohibited from carrying on any further business activity, except as is necessary to wind up its affairs or respond to civil, criminal, or administrative investigation.

As part of the asset distribution process, the parties typically execute a written agreement detailing their understanding of the transfer of the dissolving corporation’s assets. The parties may utilize such an agreement where they wish to obtain warranties regarding the absence of liabilities to be assumed by the successor corporation; account for any outstanding contractual obligations of the dissolving entity; provide for third-party consents where necessary to transfer any contractual obligations to the successor organization; or detail terms for the integration of the dissolving entity’s members. Note that in the event of any breach of warranties by the dissolving corporation, it generally will not be possible for the successor corporation to obtain redress unless the agreement specifically obligates some third party to indemnify the successor corporation, as the dissolving corporation will no longer exist.

III. Federation

A. General

A federation is generally an association of associations. Federations are most often structured along regional lines (e.g., a national association whose members are state or local associations). In some cases, a federation consists of special interest groups that represent discrete segments of the industry represented by the “umbrella” association. The national or umbrella association’s relationship with its affiliated associations is governed by formal affiliation agreements.

An affiliation agreement is a binding contract that sets forth the nature of the relationship between the parties. Most affiliation agreements include provisions that address the following: term and termination of the relationship; use of the association’s intellectual property; the provision of management services; treatment of confidential information; coordinated activities; and tax and/or financial issues, among other provisions. Where an affiliated association fails to adhere to the terms of its affiliation agreement with the national association, the affiliate could lose privileges (e.g., loss of ability to use the association’s intellectual property), become disaffiliated, or suffer some other penalty. Similarly, where a national association violates the terms of an affiliation agreement with its affiliate, it may be liable for such breach.

B. Benefits and Other Considerations

In the federation context, the national association is, for tax and liability purposes, a separate legal entity from its affiliated associations. There are instances, however, in which the separateness between two entities (even though each entity may have separate corporate and tax statuses) will be disregarded by a court or the IRS, thus creating exposure to potential legal and tax liability to both entities. Specifically, the separateness can be disregarded where the national association so controls the affairs of its affiliates, rendering it a “merely an instrumentality” of the national association.

There are two primary areas of concern for national associations that are governed by a federated structure. First and foremost, because the national association is primarily (if not completely) comprised of other associations, the income and membership of the national is generally controlled by its affiliates. Without control over these two vital areas, the national association could be susceptible to secession by an affiliate (resulting in attendant loss of income), or have its power and authority undermined by an affiliate. Second, the federated structure could cause legal or policy problems if factionalism among affiliated associations arose. Additionally, the federated structure lends itself to diluted membership loyalty toward the national association.

C. Procedural Requirements

Preliminarily, all steps must be taken to form the national association in accordance with applicable state nonprofit corporation (or association) laws. Generally, this requires a minimum of filing articles of incorporation, selecting an initial board of directors, and developing bylaws for the association. Once

the association is formed, it must apply to the IRS for recognition of tax-exempt status.

After formation, the national association must execute detailed affiliation agreements with each of its affiliated associations. There are generally no statutory requirements mandating the exercise of due diligence by any entity that chooses to enter into an affiliation agreement. Rather, the relationship is generally governed by the terms of the affiliation agreement and the general principles of contract law.

IV. Management Company Model

Associations with similar interests can affiliate through a common management structure, whereby the groups would realize the efficiencies of coordinated "back office" operations such as accounting, meeting management, IT, human resources and other supportive functions, possibly through the ownership of the non-profits by a for-profit umbrella organization. Although there are mechanisms that could be used to effect the coordinated operations that many associations seek, the idea of for-profit corporate "ownership" is problematic for several reasons, most notably tax law inhibitions on private inurement from a tax exempt entity and state corporate law restrictions.

This model (without the ownership feature) has been used in the past by a number of associations, particularly in the chemical industry, in which a nonprofit association provides management and staffing for another nonprofit corporate association which is within the scope of its exempt purposes. A historic example is the management by the Synthetic Organic Chemical Society of the Formaldehyde Institute in the 1980's and 1990's. SOCMA provided staff and management support for FI as well as a number of other chemical-specific, separate associations. This was done on a fee for service basis.

Some for-profit entities – association management companies ("AMC's") – manage the day-to-day business of numerous trade associations. The models vary depending on the resources and needs of the associations, but in almost all settings the AMC's provide the accounting, meeting planning, correspondence, communications, staffing and office requirements. In some cases, the association will have separate office identity including signage and limited access, while in others there will be common "association offices" with shared employees. There is a symbiotic relationship with respect to employees. Employees are formally employed by the AMC, but essentially report to the boards of the associations.

One critical aspect of this organizational model is that the AMC does not have an ownership interest in the nonprofit trade associations. They operate under management agreements that typically can be terminated with relatively short notice or at the conclusion of a stated term. The contractual arrangements are based on arm's length compensation, depending on the services provided.

The advantage of this model is the professionalism that an AMC or "managing association" can provide, particularly to associations that have limited means. On the other hand, there is a lack of permanency. One association could easily terminate its management company agreement and move on to a different AMC or in-house management arrangement, without the consent of the other associations. The AMC or managing association and the client association can also differ from time to time on a variety of staff or policy issues, as could two associations under this common management. In contrast, a merged or consolidated group has the solemnity of a corporate transformation which cannot be easily unraveled.

V. Other Types of Strategic Alliances

Merger, consolidation, acquisitions, and the creation of a federation involve a substantial level of commitment – but associations need not go so far in order to engage in alliances with one another. Nonprofit corporations may enter into other strategic alliances that are temporary or permanent, and allow both entities to "test the waters" before binding themselves to a more involved or permanent arrangement.

A. Partial Asset Purchase or Transfer

A lesser alternative to dissolution and transfer of all of a nonprofits assets is a limited asset purchase or transfer from one entity to another. In general, an asset purchase may be advantageous where one nonprofit entity wishes to acquire a discrete property, activity, program, or business unit of another. The directors of both organizations owe their members a significant level of due diligence prior to finalizing the deal, but, unless required under the organization's governing documents, partial asset transfers typically do not require the approval of an organization's membership. The transfer is executed pursuant to a written asset purchase agreement between the parties.

This approach has an obvious negative for the ceding organization in terms of prestige and justification for the hand-off.

B. Joint Venture

In a joint venture, two or more associations lend their efforts, assets, and expertise in order to carry out a common purpose. The associations involved may develop a new entity (such as a limited liability company or a partnership) to carry out the endeavor. Such new entity may receive tax-exempt status if it is organized and operated for exempt purposes. Generally, however, associations commit certain resources to a joint venture without forming a new entity. A well-structured joint venture is codified in a written agreement that details the precise obligations and allocation of risk between the associations involved. Joint ventures can be permanent, set to expire on a given date or after the accomplishment of a certain goal, or structured with an increasingly overlapping set of commitments and an eye towards an eventual merger. Although the bylaws of an organization might specify otherwise, joint ventures do not usually require the approval of the general membership.

In a *whole joint venture*, one or more of the partnering entities contribute all of their assets to the enterprise. Associations commonly engage in *ancillary joint ventures* with other organizations. Ancillary joint ventures are essentially small-scale joint ventures – enterprises that do not become the primary purpose of the organizations involved which are often for a limited duration. Tax-exempt organizations seeking additional sources of revenue may also enter into ancillary joint ventures with for-profit corporations, provided that the joint venture furthers the tax-exempt organization's purposes, and the tax-exempt organization retains ultimate control over, at a minimum, the exempt purposes of the joint undertaking.

C. Joint Membership Programs

Joint membership programs generally allow individuals to join two associations for a reduced fee. These initiatives allow the members of one organization to become more familiar with another, and are typically conducted in the context of other jointly run programs and activities. Programs in this vein are designed to bring associations closer together, often as a precursor to a more formal alliance, but allow the entities to modify the arrangement or disengage altogether if circumstances or expectations change.

VI. General Tax Issues

Tax-exempt associations that choose to become affiliated with other taxable or tax-exempt entities must be mindful of certain legal requirements in order to ensure that the affiliation does not jeopardize the association's tax-exempt status. This section discusses three key tax-related concepts that associations must consider prior to affiliating with another entity: unrelated business income tax, control by the tax-exempt organization, and private inurement.

A. Unrelated Business Income Tax

In general, tax-exempt organizations are exempt from federal taxes on income derived from activities that are substantially related to their exempt purposes. Nevertheless, a tax-exempt organization may still be subject to unrelated business income tax ("UBIT") on income received from the conduct of a trade or business that is regularly carried on, but is not substantially related to the organization's exempt purposes.

For the purposes of determining UBIT, an activity is considered a "trade or business" if it is carried on for the production of income from the sale of goods or performance of services. Income from a passive activity – e.g., an activity in which the exempt organization allows another entity to use its assets, for which the organization receives some payment – is not considered a business. The Code specifically excludes certain types of passive income – dividends, interest, annuities, royalties, certain capital gains, and rents from non-debt financed real property. UBIT also does not include income generated from volunteer labor, qualified corporate sponsorship payments, or qualified convention or trade show income.

An activity that is substantially related to an organization's tax-exempt purposes will not be subject to UBIT. A "substantially related" activity contributes directly to the accomplishment of one or more exempt purposes. Alone, the need to generate income so that the organization can accomplish other goals is not a legitimate tax-exempt purpose.

In the context of trade and professional associations, an activity is "substantially related" if it is

directed toward the improvement of its members' overall business conditions. The receipt of income from particular services performed to benefit individual members, although often helpful to their individual businesses, usually results in UBIT to the association where those services do not improve the business conditions of the industry overall.

An organization jeopardizes its tax-exempt status if the gross revenue, net income, and/or staff time devoted to unrelated business activities is "substantial" in relation to the organization's tax-exempt purposes. Although the "substantial" criterion has not been defined by statute or by the IRS, commentators generally agree that a level of 25-30% gives rise to concern. In an effort to prevent loss of exempt status, many tax-exempt organizations choose to create one or more taxable subsidiaries in which they house unrelated business activities. Taxable subsidiaries are separate but affiliated organizations. Generally, a taxable subsidiary can enter into partnerships and involve itself in for-profit activities without risking the tax-exempt status of its parent. Moreover, the taxable subsidiary can remit the after-tax profits to its parent as tax-free dividends. It is also beneficial in some situations to immunize the association from potential liability, by putting certain commercial activities in a separate subsidiary corporation.

B. Control

Where a nonprofit organization partners with another entity, it will continue to qualify for tax exemption only to the extent that (1) its participation furthers its exempt purposes, and (2) the arrangement permits the organization to act exclusively in furtherance of its exempt purposes. If a tax-exempt entity cedes "control" of partnership activities to a for-profit entity, the IRS will consider the partnership to serve private aims, not public interests.

In any arrangement with a for-profit entity that involves *all or substantially all* of a tax-exempt organization's assets, the IRS requires the tax-exempt organization to retain majority control over the entire undertaking – e.g., majority voting control. However, where the arrangement involves only an insubstantial portion of the tax-exempt organization's assets, the IRS has approved a structure in which the for-profit and tax-exempt organizations shared management responsibilities, but left the exempt organization in control of the exempt aspects of the arrangement.

Associations frequently enter into short-term partnerships with for-profit corporations in order to conduct a particular activity. These ventures should not jeopardize an association's tax-exempt status in most cases – even if the association does not maintain operational control over the ventures – as such activities generally are not substantial activities of the association.

C. Private Inurement

In general, organizations recognized as tax-exempt under Code Sections 501(c)(3) and 501(c)(6) are prohibited from entering into any transaction that results in "private inurement." Private inurement occurs where a transaction between a tax-exempt organization and an "insider" – i.e., someone with a close relationship with or an ability to exert substantial influence over the tax-exempt organization— results in a benefit to the insider that is greater than fair market value. An association's affiliate or partner may be considered an insider. The IRS closely scrutinizes arrangements between tax-exempt organizations and taxable entities to determine whether the activities contravene the prohibition on private inurement. Thus, an arrangement with a for-profit entity, such as a management company, must be entered at arm's-length and carefully reviewed to ensure that any benefits to insiders are at or below fair market value.

VI. Conclusion

There is an array of possible mechanisms for combinations and alliances that ABC could enter with other organizations. The selection of an appropriate structure is heavily dependent on fully identifying the goals of the transaction and the potential ramifications for both groups. We would be pleased to discuss these matters with you in more detail.

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September-October 2010

The Ins and Outs of Alliances and Affiliations

Associations Now

Related Topic Area(s): Meeting, Vendor and Government Contracts, Miscellaneous, Tax and Employee Benefits

Q: We are considering an affiliation, combination, or possible merger, with another organization. What options do we have?

A: There is a wide array of ways in which nonprofit associations can combine, affiliate or otherwise come together. Some involve a complete integration of programs, activities, membership, leadership, and staff, while some provide for maintaining varying degrees of separateness and autonomy. A summary of several options is below.

Merger. Nonprofit corporations can fully and completely integrate their programs, functions, and membership by merging. When two nonprofit entities merge, one entity legally becomes part of the surviving entity and effectively dissolves. The surviving corporation takes title to all of the assets, and assumes all of the liabilities, of the non-surviving entity.

Benefits. By merging, associations may combine their assets, reduce costs by eliminating redundant administrative processes, and provide broader services and resources to their members. Furthermore, members who paid dues and fees to participate in the formerly separate associations are often able to reduce their membership dues and the costs and time demands of association participation by joining a single, combined organization. Finally, merger may allow associations participating within the same field or industry to offer a wider array of educational programming, publications, advocacy and other services to a larger constituency in the public arena.

Mechanics. To merge with another organization, each organization must follow the procedures mandated under the nonprofit corporation law of its state of incorporation, as well as any specific procedures in its governing documents. While nonprofit corporation statutes differ by state, the laws governing merger typically set forth certain core procedures. The board of directors of each precursor organization must develop and approve a plan of merger according to the requirements set forth in the nonprofit corporation statute of the state, or states, where the organizations are incorporated. The plan of merger also must be submitted to the voting members, if any, of each organization for their approval. While the conditions for member approval vary from state to state, statutes generally require a vote of two-thirds to effectuate the plan merger – a number that can be difficult to reach for practical and political reasons.

Acquisition of a Dissolving Corporation's Assets. Another legal mechanism is the dissolution and distribution of assets of a target association. While the dissolving entity must adhere to specific statutory procedures, a dissolution is much less onerous on the entity that acquires the dissolving entity's assets (the "successor" entity) than a merger. Because the successor entity is merely absorbing the assets of another organization, a vote of the membership and accompanying state filings are typically not required for that corporation.

Benefits. An asset transfer may be strategically preferable for combining organizations when one organization is of a much smaller size than the other, or the "successor" entity is only acquiring discrete programs or assets of the dissolving entity. Another benefit is that the successor organization is typically shielded from its predecessor's debts and liabilities, though an asset transfer always poses some risk of successor liability, particularly if adequate provision has not been made for pre-existing liabilities.

Mechanics. Like a merger, an asset transfer must follow the applicable state nonprofit corporation laws and each entity's governing documents. The procedure for dissolution and asset distribution is fairly

simple for the successor entity. Member approval for such a transaction is typically unnecessary unless the organization's bylaws require otherwise. The process is more complicated, however, for the dissolving entity. In most instances, the nonprofit corporation statute of the dissolving entity's state of incorporation requires approval by both the board and any members having voting rights:

Other Types of Strategic Alliances. Mergers and asset acquisitions involve a substantial level of commitment, but associations need not go so far in order to engage in alliances with one another. Nonprofit corporations may enter into other strategic alliances that are temporary or permanent, and allow both entities to "test the waters" before binding themselves to a more involved or permanent arrangement.

Joint Venture. For example, in a joint venture, two or more associations lend their efforts, assets, and expertise in order to carry out a common purpose. The associations involved may develop a new entity (such as a limited liability company or a partnership) to carry out the endeavor. One example is joint trade shows.

A well-structured joint venture is codified in a written agreement that details the precise obligations and allocation of risk between the associations involved. Joint ventures can be permanent, set to expire on a given date or after the accomplishment of a certain goal, or structured with an increasingly overlapping set of commitments and an eye towards an eventual merger. Although the bylaws of an organization might specify otherwise, joint ventures do not usually require the approval of the general membership.

In the event that a contemplated joint venture would involve a taxable entity or an organization that is exempt under a different section of the tax code, there are additional precautions that may need to be taken in order to protect your organization from incurring taxable income or jeopardizing its exempt status.

Joint Membership Programs. Joint membership programs typically allow individuals to join two associations for a reduced fee. These initiatives allow the members of one organization to become more familiar with another, and are usually conducted in the context of other jointly run programs and activities. Programs in this vein are designed to bring associations closer together, often as a precursor to a more formal alliance, but allow the entities to modify the arrangement or disengage altogether if circumstances or expectations change.

Conclusion. There is an array of possible mechanisms for combinations and alliances that available to associations. The selection of an appropriate structure is heavily dependent on fully identifying the goals of the transaction and the potential ramifications for both groups.

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Nonprofit Partnerships: A Guide to the Key Legal Issues and Pitfalls

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This article uses the term “partnership” as most people would use the word when speaking to one another. When two or more people, or two or more groups of people, pool their resources together and collaborate to achieve a common purpose, it is fair and accurate to call them “partners.” From a legal sense, however, the term “partnership” is a term of art—when lawyers describe two entities as “partners,” they are speaking about a particular type of legal arrangement. From a lawyer’s perspective, a “partnership” is a complex interaction of business law, tax law, and the rules of intellectual property.

Still, for all the legal complexity that often comes with forging partnerships, maintaining them, and amicably parting ways, there are a few basic steps that every nonprofit can take to better understand the law of partnerships. This article lays out some basic terminology, then explains the tax and intellectual property implications involved in forming partnerships. It concludes by highlighting provisions that should be included in every partnership agreement, no matter what the technical form of the relationship.

I. Terminology

Strictly speaking, a “partnership” is an unincorporated business organization created by contract between two or more entities in order to carry out a common enterprise. Each partner contributes money, property, labor, or skill, and expects to share in the profits and losses of the undertaking. Generally speaking, a partnership does not pay income taxes; instead, the individual partners report their share of the partnership’s profits or losses on their individual tax returns.

Within this legal definition, there are several categories of partnership, each with its own balance of management rights and personal liability. There are also several forms of cooperation that fall short of the technical definition of “partnership,” but are nonetheless advantageous to nonprofits not yet ready to commit to a long-term relationship with another entity.

A. *General Partnership*

In a general partnership, each partner shares equal rights and responsibilities in connection with the management of the partnership, and any partner has the authority to bind the entire partnership to a legal obligation. Unlike shareholders in a corporation, the members of a general partnership are personally liable for all of the partnership’s debts and obligations. That amount of personal liability is often daunting, but it comes with a significant tax advantage: partnership profits are not taxed to the business. Instead, profits *pass through* to the partners, who include the gains on their individual tax returns.

B. *Limited Partnership*

In a limited partnership, partners are divided into two classes—general partners and limited partners. The personal liability of a limited partner is limited to the amount he or she has actually invested in the partnership; as a trade-off, however, limited partners are not permitted to participate in management decisions. At least one partner in a limited partnership must be a general partner. General partners retain the right to control and manage the limited partnership, but assume full personal liability for the partnership’s debts and obligations.

C. *Limited Liability Partnership*

In a limited liability partnership (“LLP”), all partners may directly participate in the management of the partnership and are granted some protection from the partnership’s liability—although the extent of

that protection varies from state to state. Some states tax limited liability partnerships as corporations, although they are considered partnerships under federal law. Many states also make the LLP available only to certain professional businesses—e.g., law and accounting firms—and mandate that LLPs adhere to specific filing requirements.

D. Limited Liability Company

A limited liability company (“LLC”) is a relatively new type of business structure created by state statute. Unlike general partnerships, which were developed over time by case law and require no formal documentation for creation, LLCs are created by filing a document (usually referred to as “Articles of Organization”) with the state. LLC owners (called “members”) are not personally liable for the debts and obligations of the LLC. In most cases, an LLC will be taxed like a general partnership—that is, the LLC itself will not be taxed, and the individual members will report their share of profits and losses on their individual tax returns. An LLC may, however, elect to be taxed as a corporation.

E. Joint Venture

A joint venture is an enterprise jointly undertaken by two or more entities for the limited purpose of carrying out a single transaction or isolated project. Unlike a partnership agreement, which creates a new entity and anticipates a long-term and continuous relationship, a joint venture usually ends once the limited purpose of the joint venture is complete. A joint venture can be structured like a general or limited partnership or an LLC, although LLCs are often preferred because of the additional liability protection and tax advantages. Similarly, joint ventures can be structured with an increasingly overlapping set of commitments between the parties and an eye towards eventually entering a more formal relationship. In any event, a well-structured joint venture will be codified in a written agreement that details the precise obligations and allocation of risk between the parties involved.

In a *whole joint venture*, one or more of the partnering entities contributes all of its assets to the enterprise. Nonprofit organizations more commonly engage in ancillary joint ventures. *Ancillary joint ventures* are essentially small-scale joint ventures—enterprises that do not become the primary purpose of the organizations involved. Organizations typically engage in ancillary joint ventures for a limited duration, and memorialize the terms of their arrangement in a written agreement. For example, nonprofits may enter into an arrangement with another organization to host a convention, publish a newsletter, or provide a series of educational programs. Tax-exempt organizations seeking additional sources of revenue also may enter into ancillary joint ventures with for-profit corporations, as long as doing so furthers the tax-exempt organization’s purposes and the tax-exempt organization retains ultimate control over the underlying activity. Nonprofits often create new entities from which to undertake the joint venture. Depending upon the nature of the activity contemplated, such an organization may or may not be eligible for tax-exempt status.

Joint membership programs allow individuals to join two nonprofits typically, for a reduced fee. These initiatives allow the members of one organization to become more familiar with another, and are typically conducted in the context of other jointly-run programs and activities. Again, programs in this vein are designed to bring nonprofits closer together, often as a precursor to a more formal alliance, but allowing the entities to tinker with the arrangement or disengage altogether if circumstances or expectations change.

F. Independent Contractor Relationships

An independent contract relationship is an agreement between two or more entities for the provision of goods or services under the terms specified in the agreement. For the most part, independent contractors are defined by the IRS’s “facts and circumstances” test. For instance, if the nonprofit hiring the contractor has the right to control or direct the result of the work, but not the means of accomplishing the work, then this will be a factor in favor of characterizing the arrangement as an independent contractor relationship. Otherwise, the contractor may be treated as an employee of the nonprofit, whose earnings are subject to withholding for employment tax purposes. The employee also may be eligible for employee benefits from the nonprofit, among other significant implications.

G. Commercial Co-Venture

A commercial co-venture (sometimes referred to as a “charitable sales promotion”) generally consists of an arrangement between a charitable organization and a for-profit entity that otherwise engages in a trade or business. In most cases, the for-profit entity agrees to promote the sale of a product or service and represents that part of the sales proceeds will benefit a charitable organization or charitable purpose. Commercial co-ventures generally resemble independent contractor relationships

more than partnerships, LLCs or joint ventures.

Commercial co-ventures are a relatively new idea, and the body of law addressing them is still developing. Presently, 24 states expressly regulate commercial co-ventures. Although none of these states require the commercial co-venture to form a separate business entity, many do require that both the for-profit corporation and the charitable organization file a written contract with the state before engaging in any sales or charitable solicitations.

II. Tax Issues for Tax-Exempt Organizations¹

Because the terms of a partnership often implicate the tax-exempt purposes of an organization, tax-exempt entities must be mindful of the Internal Revenue Code (“IRC”) and the conditions of tax-exempt recognition. This section discusses four central tax concepts for nonprofits to consider before signing any partnership agreement: unrelated business income tax, control by the tax-exempt organization, private inurement and private benefit, and compliance with state charitable solicitation laws.

A. Unrelated Business Income Tax

In general, tax-exempt organizations are exempt from federal taxes on income derived from activities that are substantially related to the organization’s exempt purpose. A tax-exempt organization may still be subject to unrelated business income tax (“UBIT”). UBIT is a federal income tax imposed on tax-exempt organizations for income derived from a trade or business that is carried on regularly, but is not substantially related to the organization’s exempt purposes. This tax is generally imposed at the federal corporate income tax rates.

For the purposes of determining UBIT, an activity is considered a “trade or business” where it is carried on for the production of income from the sale of goods or performance of services. Income from a passive activity—*i.e.*, an activity in which the exempt organization allows another entity to use its assets, for which the organization receives some payment—is not considered a business. The IRC specifically excludes certain types of passive income from UBIT—dividends, interest, annuities, royalties, certain capital gains, and rents from non-debt financed real property. UBIT also does not include income generated from volunteer labor, qualified corporate sponsorship payments, or qualified convention or trade show income.

In determining whether an activity is “regularly carried on,” the IRS will examine: (1) the frequency and continuity with which the activity is conducted; and (2) the manner in which it is pursued. These factors will be compared with the same or similar business activity of non-exempt organizations. Discontinuous or periodic activities are generally not considered “regularly carried on,” and generally do not result in UBIT.

An activity that is substantially related to an organization’s tax-exempt purposes will not be subject to UBIT. A “substantially related” activity contributes directly to the accomplishment of one or more of the organization’s exempt purposes. Alone, the need to generate income so that the organization can accomplish other goals is not considered a tax-exempt purpose.

In the context of trade and professional associations, for example, an activity is “substantially related” if it is directed toward the improvement of its members’ overall business conditions. Particular services performed to benefit individual members, although often helpful to their individual businesses, usually results in UBIT to the association where those services do not improve the business conditions of the industry overall.

UBIT is even a consideration where a partnership is formed by two otherwise tax-exempt organizations. To the extent that the activities of a partnership do not further the exempt purposes of either organization, income from the partnership may be subject to UBIT. Notably, if two tax-exempt entities form an LLC operated exclusively for exempt purposes and consisting solely of exempt members, the LLC itself may seek exemption under Section 501(c)(3) of the IRC. Accordingly, if such exemption is recognized by the IRS, the income of the LLC would not be subject to tax. In contrast, the IRS will not grant general or limited partnerships exempt status, even if all of the partners thereof are exempt organizations.

Under the UBIT rules, deductions are permitted for expenses that are “directly connected” with the carrying on of the unrelated trade or business. If an organization regularly carries on two or more unrelated business activities, its unrelated business taxable income is the total of gross income from all such activities less the total allowable deductions attributable to such activities.

An organization can jeopardize its tax-exempt status if the gross revenue, net income, and/or staff

time devoted to unrelated business activities is “substantial” in relation to the organization’s tax-exempt purposes. In an effort to prevent loss of exempt status, many tax-exempt organizations choose to create one or more taxable subsidiaries in which they may house unrelated business activities. Taxable subsidiaries are separate but affiliated organizations. A taxable subsidiary can enter into partnerships and involve itself in for-profit activities without risking the tax-exempt status of its parent. Moreover, the taxable subsidiary can remit the after-tax profits to its parent as tax-free dividends.

B. Control

In a partnership, a nonprofit organization continues to qualify for tax exemption only to the extent that (1) its participation furthers its exempt purposes and (2) the arrangement permits the organization to act exclusively in its own interests and in the furtherance of those exempt purposes. If a tax-exempt entity cedes “control” of partnership activities to a for-profit entity, the IRS will consider the partnership to serve private aims, not public interests.

In a partnership with a for-profit entity that involves all or substantially all of a tax-exempt organization’s assets, the IRS generally requires the tax-exempt organization to retain majority control over the partnership—*e.g.*, a majority vote on the governing board. In a similar arrangement that involves only a portion of the tax-exempt organization’s assets, the IRS has approved a structure in which the for-profit and tax-exempt organizations share most management responsibilities but leave the exempt organization in charge of the exempt aspects of the partnership. Even in a partnership consisting solely of tax-exempt organizations, the management of the partnership must remain with tax-exempt organizations and may not be delegated to for-profit entities.

Nonprofits frequently enter into short-term partnerships with for-profit corporations in order to conduct a particular activity. These ventures should not jeopardize the nonprofit’s tax-exempt status in most cases—even if the nonprofit does not maintain operational control over the venture—because the nonprofit will still carry on substantial tax-exempt activities.

C. Private Inurement and Private Benefit

In general, organizations recognized as tax exempt under Sections 501(c)(3) and 501(c)(6) of the IRC are prohibited from entering into a transaction that results in “private inurement.” Private inurement occurs where a transaction between a tax-exempt organization and an “insider”—*i.e.*, someone with a close relationship with, or an ability to exert substantial influence over, the tax-exempt organization—results in a benefit to the insider that is greater than fair market value. The IRS closely scrutinizes partnerships between tax-exempt organizations and taxable entities to determine whether the activities contravene the prohibitions on private inurement and on excess private benefit (see below).

Private inurement through dealings with tax-exempt organizations can carry with it individual penalties as well. The IRS may levy excise taxes (referred to commonly as “intermediate sanctions”) against “disqualified persons” that receive better-than-fair-market-value in transactions with 501(c)(3) and 501(c)(4) organizations. A “disqualified person” is any person who is in a position to exercise substantial influence over the tax-exempt organization, or has been in the past five years. Directors, officers, and the immediate family of directors and officers are all disqualified persons, among others.

501(c)(3) organizations also are prohibited from entering into transactions that result in more-than-incidental “private benefit” to another party, including unrelated third parties. Incidental benefits related to an organization’s tax-exempt purposes are not considered private benefits, but the benefits must be both quantitatively and qualitatively incidental. To be quantitatively incidental, the private benefit must be insubstantial when compared to the overall tax-exempt benefit generated by the activity. To be qualitatively incidental, the private benefit must be inextricable from the exempt activity, in that the exempt objectives could not be achieved without necessarily benefitting certain individuals privately.

While the private inurement prohibition and the private benefit doctrine may substantially overlap, the two are distinct requirements which must be independently satisfied.

D. Charitable Solicitation Statutes

Over the last two decades, the vast majority of states and the District of Columbia have enacted and strengthened charitable solicitation statutes, designed to guard against fraudulent or misleading fundraising solicitations. The term “charitable solicitation” generally refers to requests for contributions to a tax-exempt organization or for a charitable purpose. Many state statutes restrict the application of their charitable solicitation statutes to organizations recognized as tax-exempt under Section 501(c)

(3); others apply such statutes to all tax-exempt entities. Solicitations may take many forms, including Internet and telephone appeals, special fund-raising events, and direct-mail campaigns. Any partnership that engages in a charitable solicitation must adhere to the state requirements in each state in which such solicitation occurs.

While the specifics of these statutes vary by state, they generally require tax-exempt organizations to register before soliciting contributions from residents of the state. Registration typically involves providing general information (*e.g.*, name, address, corporate status, purpose, proposed registration activities, tax status, information about officers and directors, etc.) about the tax-exempt organization.

Many states also impose reporting and disclosure requirements. Tax-exempt organizations are typically required to file a report or other financial information with the state on an annual basis. Many states make all or most of these reports and registrations available to the public. Some states also require solicitors to disclose certain information—*e.g.*, the nature of the organization's activities and the amount of a donation actually designated for charitable purposes—at the request of a prospective donor.

As commercial co-ventures have gained popularity, many states have enacted statutes that specifically address and regulate arrangements between non-profit and for-profit entities. Under these statutes, the for-profit partner may be subject to reporting and accounting requirements to both the tax-exempt organization and the state. Alternatively, states may subject the partners of a commercial co-venture to the registration and bonding requirements usually reserved for professional fundraisers and solicitors.

Failure to comply with charitable solicitation statutes may result in sanctions against the tax-exempt organization, including investigations, revocation of registrations, injunctions, and civil and criminal penalties. Because of the variances in state filing requirements, compliance is often burdensome when nonprofit organizations contemplate solicitation programs that will span several states. This burden is somewhat eased by the fact that 35 states and the District of Columbia have agreed to accept a uniform registration form; however, many of these jurisdictions also require state-specific attachments—*e.g.*, a Form 990, audited financial reports, and/or copies of partnership agreements—to complete the charitable organization's registration.

III. Protecting Intellectual Property within Partnerships

The various types of partnerships discussed previously all likely will result in the creation of or involve the use of some form of intellectual property. Perhaps a company and a charity partner together to promote a "green" program on each other's websites. Nonprofits often come together to produce an educational conference, convention or trade show. Several different types of organizations might enter into a partnership to create the definitive publication on best practices in a given field or industry.

These business ventures, and many others, likely involve the development of products or written works, advertising and marketing literature, the sharing of logos and organization names, and/or the use of membership and customer lists to market the program. In addition, business activities like these often require a nonprofit to share its trademarks, trade secrets, and copyrights. All of these things constitute intellectual property. When such intellectual property assets are managed poorly, an organization runs the risk of damaging or diluting its rights in its own intellectual property assets and potentially infringing upon the rights of others. If managed properly, these assets can remain protected even as they are used to accomplish the goals of the business venture.

In short, a rudimentary understanding of the basics of trademark, trade secret, and copyright law can go a long way toward giving an organization the flexibility it needs to successfully launch new partnerships and business activities.

A. Trademark Basics

An organization's name and acronym may be "trademarks" protected by law. By definition, a trademark is any word, phrase, symbol, design, slogan, or tag line (or combination thereof) used by a company, individual or nonprofit to identify the source of a product. A service mark is the same as a trademark except that it identifies the source of a service. A certification mark is a mark used by an authorized third party to indicate that their products or services meet the standards set by the owner of the mark. It is important to note, however, that there are several exceptions that prevent a mark from being a protected trademark under the law, including the fact that the mark is too generic or is a merely descriptive term.

B. Trade Secret Basics

The term “trade secret” is generally defined as information used in a business that provides a competitive advantage to its owner and is maintained in secrecy.² Almost any type of information, if truly valuable, not readily known in the industry, and properly protected, may constitute a trade secret. Trade secret information might include (1) business information; (2) customer or member lists and related confidential information; (3) procedures, such as employee selection procedures, business methods, standards and specifications, inventory control, and rotation procedures; (4) financial information; (5) advertising and marketing information; (6) processes and methods of manufacture; (7) designs and specifications; and (8) computer software.

C. Copyright Basics

While they often may not realize it, organizations create and use copyrighted works on a regular basis. Under the federal Copyright Act, a copyright automatically vests in the author of a work as soon as the work is fixed in some tangible medium of expression. Essentially, when any entity puts pen to paper and an original work appears, a copyright exists. The copyright may be owned by a single author, or by two or more contributors who are joint authors or co-authors. A “joint work” is one created by two or more authors who intend their contributions to be merged into a single work. As a matter of law, each co-author of a copyrighted work has an independent right to use and exploit the entire work, but must share the profits equally and provide an accounting to the other co-author.

Organizations frequently miss a key copyright principle: the law treats works created by independent contractors and other non-employees differently than works created by an organization’s employees. Materials created by an organization’s employees generally are presumed to be the property of the organization, even absent a written copyright transfer or agreement, thus making the organization the owner of the copyright in such works. However, even if an organization has conceived of the idea for a work, supervised its development, and funded its creation, an independent individual (e.g., an independent contractor or any other non-employee) hired to create a work retains the copyright in that work unless he or she explicitly transfers it back to the organization by way of a written agreement. Even articles and graphics used and reused in the regular publications of a nonprofit may remain the intellectual property of their original creators and owners. If the organization wishes to continue to use such a work, it must obtain permission from the copyright owner and may be required to pay a licensing fee.

D. Preventative Measures

To protect and maximize an organization’s intellectual property rights and avoid infringing upon the intellectual property rights of others, the organization should take the following preventative steps, either on an ongoing basis or in contemplation of a new business venture:

- **Register copyrights.** Register the content on websites, publications and all other important, original, creative works that are fixed in any print, electronic, audio-visual, or other tangible medium with the U.S. Copyright Office. Although such registration is not required to obtain and maintain a copyright in a work, it is a prerequisite to filing a lawsuit to enforce the rights in such works and it confers other valuable benefits. Copyright registration is generally a simple, inexpensive process that can usually be done without the assistance of legal counsel.
- **Register trademarks.** Organizations should register their name, logos, slogans, certification marks, and all other important marks with the U.S. Patent & Trademark Office. While federal registration of marks is not required to obtain and maintain trademark rights, it can be extremely helpful in enforcing and maintaining them. Trademark registration, although a bit more expensive than obtaining copyright registration, is still an affordable process, particularly when one considers that trademarks and service marks generally protect the actual identity of an organization or its brand(s). As a result, the ability to fully enforce an organization’s trademark or service mark rights through registration is paramount.
- **Use copyright and trademark notices.** Use copyright notices (e.g., “© 2011 Venable LLP. All rights reserved.”) on and in connection with all creative works published by your organization, and trademark notices on and in connection with all trademarks, service marks, and certification marks owned and used by your organization (e.g., “TM” for non-registered marks and “®” for federally registered marks). While copyright and trademark notices are not required, their effective use can significantly enhance intellectual property rights, including putting others on notice as to their protection and preventing others from asserting the defense of “innocent infringement.”
- **Verify ownership and permission to use all intellectual property.** An organization should

ensure that it owns all intellectual property or has appropriate permission to use all intellectual property belonging to third parties that appears in its publications, on its website and in any other media, and should maintain and update such permissions on a regular basis. It is notable that, generally speaking, more copyright problems arise in this area than any other. If an organization discovers that it does not own intellectual property that it seeks to use as part of a partnership or business venture, it may be required to obtain permission from and pay a licensing fee to the owner of the work in order to make lawful use of the work.

- **Police use of your intellectual property.** Police the use of your copyrights and trademarks by others and enforce your rights where necessary. Trademark law requires the owner of a trademark or service mark to take measures to enforce its rights in such trademarks or service marks. An organization may use periodic web searches, outside watch service vendors, or other means to do so. Enforcement does not necessarily involve the filing of a lawsuit.

E. Contractual Protections

It cannot be emphasized enough that organizations entering into a business venture should memorialize their arrangement in a written contract. Among the other issues discussed in this article, a written agreement will ensure that the ownership rights (or at least sufficient license rights) to all intellectual property created under the agreement are apportioned among the business partners as they intend. If ownership of works is not spelled out in an agreement, the default copyright laws discussed above will apply, among others. The following are key issues that partnering organizations should address in their written agreements:

- **Ensure confidentiality—either up-front or in the partnership contract.** Potential business partners should enter into a written confidentiality agreement up-front—while they are ironing out the business terms—to protect the tentative deal, trade secrets, and any other intellectual or proprietary property revealed through the process of negotiations and due diligence investigations. Alternatively, the parties can address confidentiality in the comprehensive written contract that outlines their business venture.
- **Include an intellectual property license.** Any time an organization allows any other individual or entity—be they members, affiliated entities, or business partners—to use its trademark, service marks, name, logos, copyrighted works, other intellectual property, or proprietary information (such as names, addresses, and other contact information contained in its membership or customer directory or list), it is licensing those rights to the other party. The terms and conditions of such a license should be in writing and the writing should include certain provisions regarding the policing of the use of such intellectual property by others.

The license of an organization's intellectual property to the other partner generally should be limited solely to the scope and purpose of the business venture contemplated under the agreement, and should cease immediately upon termination. The owning partner should explicitly retain all key copyright, trademark, patent, and domain name rights created under the agreement; retain its ownership and control of the "look and feel" of any of its content used on a website; retain quality control over the use of any trademark, service mark, name, logo, or other indicator of source of any product or service; restrict the use of its name, logo and membership list; obtain confidentiality and security assurances regarding the use of its customer or membership data and other information; and obtain a warranty by the licensee partner that it will use no infringing or otherwise illegal material in connection with its use of the owning partner's intellectual property.

- **Minimize liability risk through representations and warranties.** An effective contract will include sufficient representations and warranties that each partner's intellectual property, software, website, and other elements that it brings to the venture do not infringe any intellectual property or other rights of third parties, do not violate any applicable laws and regulations, and that each partner will perform as promised.
- **Spell out rights upon termination.** While the parties may intend for their brilliantly-conceived business venture to continue forever, even the best plans end or change. Thus, one of the most important issues to address in advance in the original written contract is what happens to each party's intellectual property assets upon termination. Joint authors who formerly shared all rights, expenses and revenues may want to buy one another out upon termination, or ensure that the other party cannot use or alter their joint work once they part ways. Partner organizations should consider whether derivative works can be created after termination, and if so, to what extent. The key is for partners to think ahead about what assets they expect to keep or to gain, what rights they wish to protect, and how to enforce those rights at and after termination. In certain cases, a

written agreement may be required to alter the statutory default provisions that govern ownership rights related to these types of considerations.

- **Maintain agreements with contractors, authors and speakers.** Partnering organizations also should maintain written contracts with any contractors and non-employee authors and speakers utilized under their business plan. If the ownership of works is not spelled out in a written agreement, the default copyright rule generally will apply, *i.e.*, the person who creates the work is the one who owns it, regardless of who conceived of or paid for the work. An exception to that general rule is represented in the work-made-for-hire doctrine. If a work qualifies as a “work-made-for-hire” under the law, the entity commissioning the work is considered its author and is the copyright owner, not the individual who created the work.³ This area of the law is complex and many works may not qualify under the word-made-for-hire doctrine (the doctrine is only applicable to certain limited, expressly-defined categories of works). Among other requirements, in order for a work to be considered a work-made-for-hire, a written agreement reflecting such status is necessary.

A written agreement with any non-employees should contain a section that provides that (1) works created pursuant to the agreement are “works-made-for-hire;” (2) to the extent a work is not a work-made-for-hire under the statute, the non-employee author, creator or speaker assigns the copyright to the organization; and (3) in the event that the non-employee will not agree to assign its work to the organization, the non-employee grants the organization a broad, irrevocable, worldwide, royalty-free, and exclusive license to the work in any manner in the future.

IV. Issues to Consider before Signing the Agreement

After considering the relevant tax and intellectual property issues and choosing the appropriate legal structure for the partnership envisioned, a nonprofit’s staff must delve into the specific details. No partnership agreement is complete without taking certain matters under consideration:

- **Due Diligence and Quality Control:** Before entering into any partnership agreement, a nonprofit should become familiar with its potential partner. Nonprofit leadership is obligated to exercise due diligence on this front, and nonprofit staff should be prepared to check references and review key legal, financial, corporate, and insurance documents. Avoiding negligence in the selection process—and on an ongoing basis—is key to avoiding liability for the errors and omissions of a partner.
- **Confidentiality:** While not essential, it often is prudent for a nonprofit to enter into a confidentiality agreement with a potential partner *prior* to beginning negotiations over the partnership agreement. Such an agreement can help ensure that the nonprofit will not be damaged or put at a competitive disadvantage by the disclosure or improper use of sensitive information or documents.
- **Intellectual Property:** Engaging in a business venture with another entity almost always involves the use of one another’s intellectual property and frequently the creation of new works. Each organization should include a license to its intellectual property that limits the other partner’s use of that property solely to the purposes of the partnership. An organization must preserve the right to maintain quality control over any use of its trademarks, service marks, name, logos, or any other indicator of the source of a product or service. Both partners should address who will own any works created by the partnership—both while it exists and after it terminates—as well as the rights to share in revenue related to such works and the right to create derivative works based on such works.
- **Choosing the Right Form:** As discussed above, each form of partnership has its own liability and tax considerations. Be specific. For example, an agreement to enter into a joint venture should state so explicitly. An agreement that represents a limited, one-time arrangement should contain a clause that states that is the intention of the parties that it be a limited, one-time arrangement.
- **Comply with Tax-Exemption Requirements:** As previously noted, tax-exempt organizations have to abide by special tax rules in order to maintain their tax-exempt status. A nonprofit’s tax-exempt status is preserved by continuously monitoring the amount of the resources devoted to a partnership that generates unrelated business income, as well as limiting the unrelated business income itself. The agreement should state that the tax-exempt entity, at the very least, maintains control over the tax-exempt purposes and activities of the partnership.
- **Performance Obligations and Performance Standards:** A partnership agreement must be clear about the precise obligations of each partner, and should err on the side of being too specific. Partners should be required to perform with high standards of quality, professionalism and

expertise, and the agreement should contemplate adverse consequences for a party that fails to satisfy these standards.

- **Timeline:** Any time constraints should be stated in the agreement. The phrase “time is of the essence” may be used to prevent late performance.
- **Indemnification:** Most partnership agreements contain an indemnification clause. The basic obligation is that if one partner’s negligence or misconduct causes another partner to be sued by a third person, then the party at fault is responsible for any expenses resulting from the suit, including judgments, damages, settlements, and attorney’s fees and court costs.
- **Antitrust Compliance:** Any provision that fixes prices, limits competition, allows for the exchange of competitively-sensitive information, attempts to set industry standards, restricts membership in a nonprofit, limits access to particular products or services, limits the production of particular products or services, or attempts to restrict who may do business with whom in an industry, likely is suspect to scrutiny under federal and state antitrust laws. While not necessarily illegal, extreme care and prudence should be exercised. If the agreement implicates any of these—or otherwise limits competition in any way—consult with legal counsel before proceeding.
- **Representations and Warranties:** Every party to a partnership agreement should be willing to make certain basic guarantees (often called representations and warranties)—to respect the rights of third parties, to follow all applicable laws and regulations, to sign the agreement only if actually authorized to do so, and to perform all obligations in good faith and fair dealing. Many partnership agreements also spell out particular consequences for breach of these guarantees.
- **Term, Termination and Transition:** All good partnership agreements contemplate an exit strategy at every stage of the enterprise. A solid agreement will spell out the initial term of the contract, whether and how the term will automatically renew, and when and how the agreement may be terminated. Unless the agreement specifies otherwise, the law generally will permit a partner to assign its rights and obligations under the partnership agreement to any third party, as well as to terminate the agreement at any time for any reason. Nonprofits can avoid costly disputes at the end of a relationship by deciding, up front, which partners will take which assets with them when they leave the partnership, or at least specifying a process for making such determinations.

This list is by no means exclusive. All partnership agreements should be in writing and generally should be reviewed by legal counsel.

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This article is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can only be provided in response to a specific fact situation.

NONPROFIT JOINT VENTURE, AFFILIATION & COLLABORATION DECISION CHART

What Are You Doing?

Mission & Taxation Analysis

Liability Analysis

Cashing Checks

Providing Resources or Engaging in Activity

Related to Mission

UBIT Exception

Unrelated/ No Exception

Substantial Liability

Little Liability

Insubstantial

Substantial

Separate Entity
Tax, Formality and Funding Issues Determine Form

Contract & Insurance
Unless There Are Substantial Liability Concerns Go to Tax Analysis

Contract & Insurance
Unless There Are Substantial Liability Concerns Go to Liability Analysis

C-Corp Subsidiary
Taxed at Entity Level Unless Tax-Exempt Recognition Obtained

Separately Taxed LLC
Taxed at Entity Level Unless Tax-Exempt Recognition Obtained

Disregarded LLC
Only Use Where Activity is Related or Unrelated but Insubstantial Go to Tax Analysis

Control

Less Control

Taxation Dependent on Activity Analysis

Parent Receives Tax-Free Dividends

Parent Receives 512(b) Income Tax-Free

Taxation Dependent on Activity Analysis