

Nonprofit Chapters and Sections: Animating Component Activities while Managing Legal Risk

Thursday, March 24, 2022, 12:30 p.m. – 1:30 p.m. ET

Moderator

George E. Constantine

Partner and Chair, Nonprofit Organizations, Venable LLP | 202.344.4790 | geconstantine@Venable.com

Speakers

Judith Y. Kim

Counsel, Nonprofit Organizations, Venable LLP | 202.344.4309 | jykim@Venable.com

Andrew L. Steinberg

Associate, Nonprofit Organizations, Venable LLP | 202.344.4202 | alsteinberg@Venable.com

VENABLE LLP

Today's Discussion

- Reasons for forming chapters
- Common chapter-national structures
- Key legal pitfalls
 - Attribution of liability to national or individual leaders
 - Protecting national's intellectual property
 - Governance-related challenges
- Tax-exemption considerations
- Managing chapter relationships
 - Key provisions in affiliation agreement
 - Key provisions in governing documents
- Practical tips for maintaining good relationships with chapters

Terminology

- **National:** Main organization with national/international reach
- **Sections:** Subsections of national organization operating on a local level
- **Sections = chapters = regions**
- Other affiliate organizations that engage in different activities and with potentially different tax-exempt status are outside the scope of this presentation

Reasons for Forming Chapters

Local member
engagement

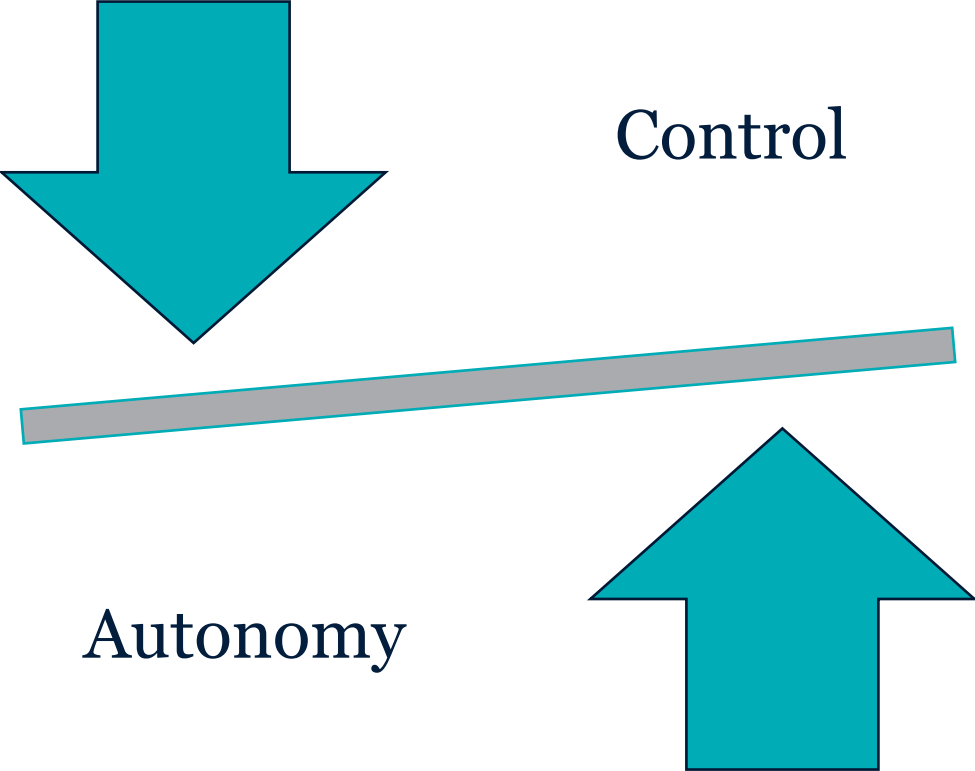
Enhancing
member
benefits

Development of
potential
national leaders

More
sponsorship
opportunities

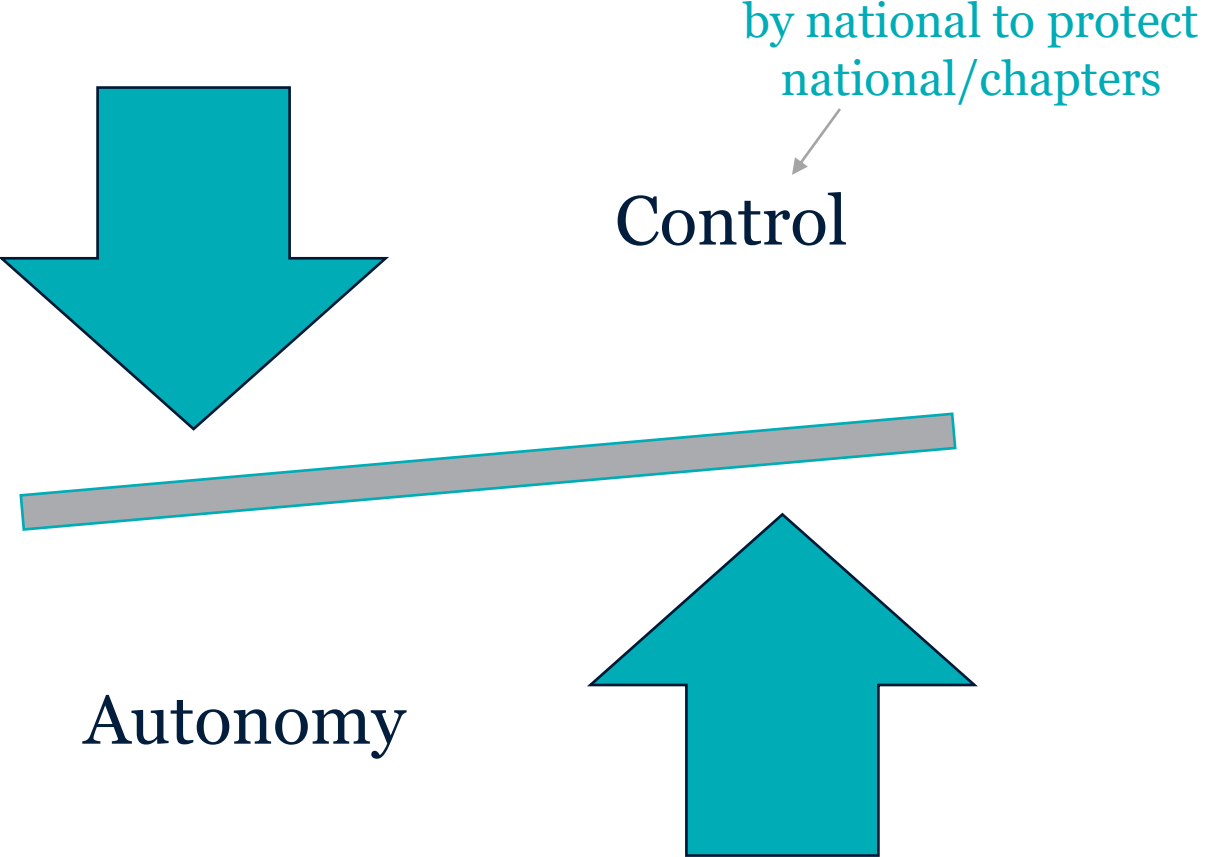
Common Chapter-National Relationships

Control v. Autonomy: Key Factor



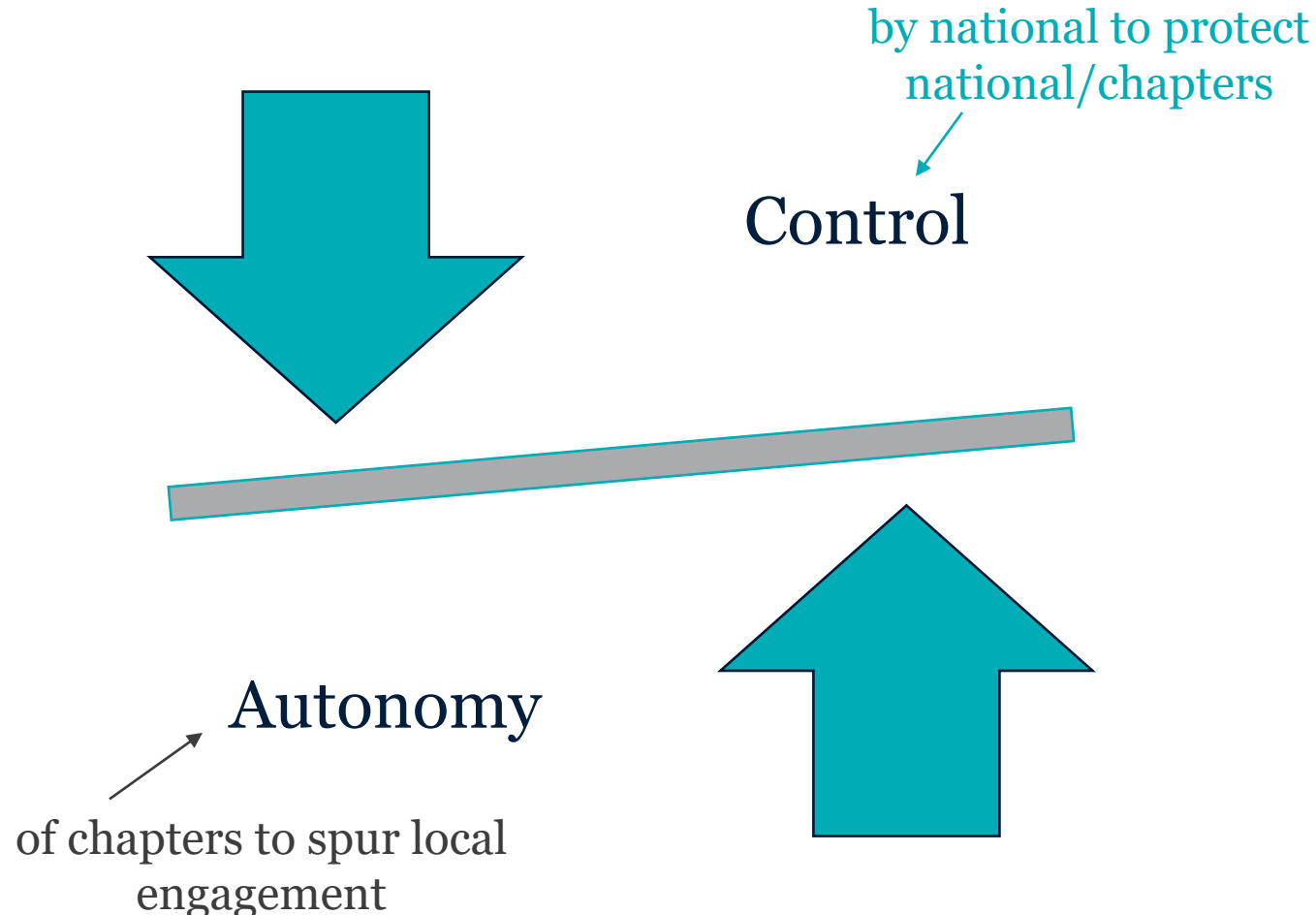
Common Chapter-National Relationships

Control v. Autonomy: Key Factor



Common Chapter-National Relationships

Control v. Autonomy: Key Factor



Common Chapter-National Relationships

Control/Autonomy Continuum

Fully integrated

- chapters have no separate legal existence
- e.g., chapters use national's EIN for bank account

Unincorporated chapters

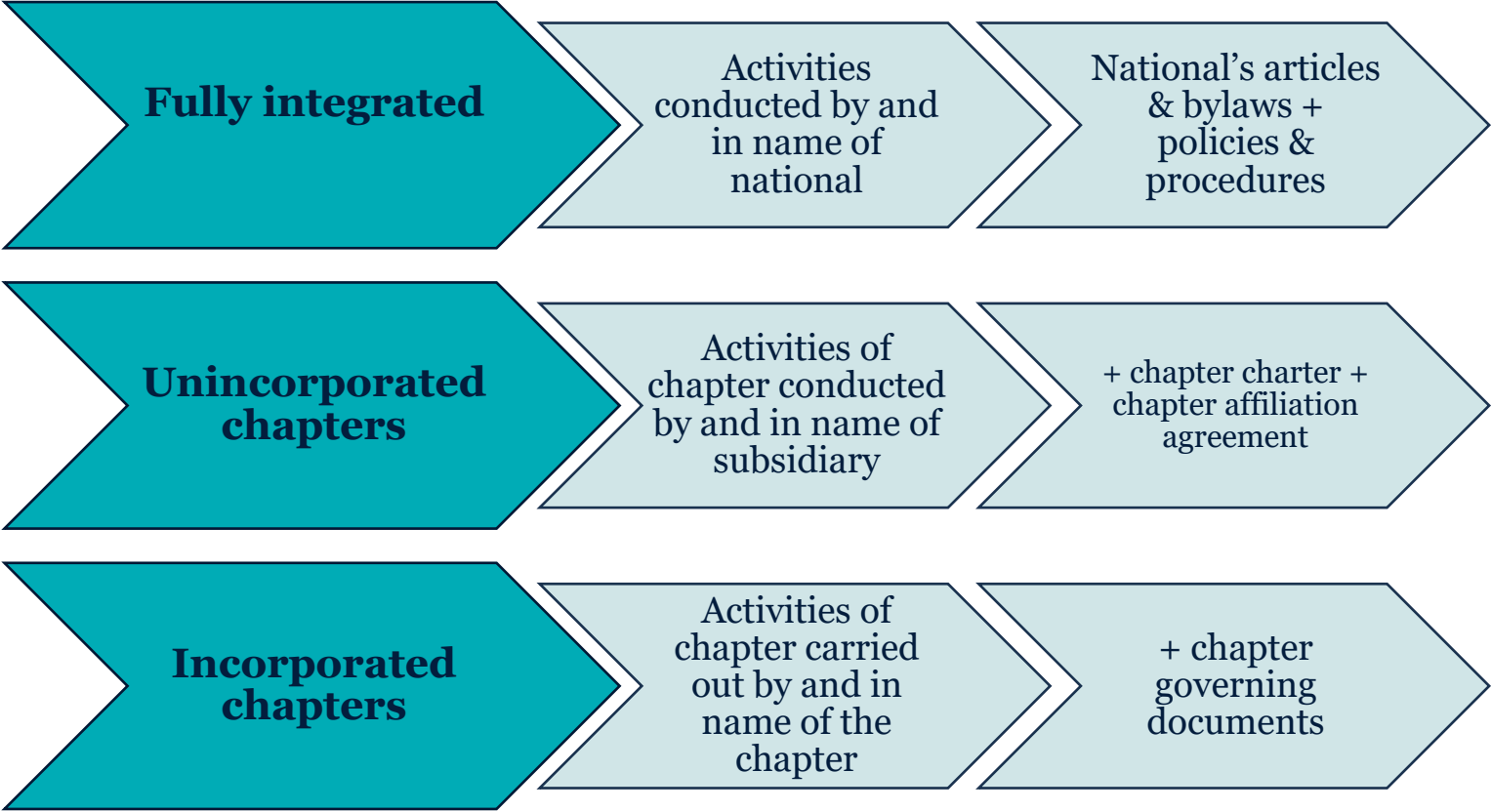
- unincorporated chapters
- chapter relies on national for many of services, e.g., insurance

Incorporated chapters

- separately incorporated chapters
- chapter operates independently from national (including separate board)

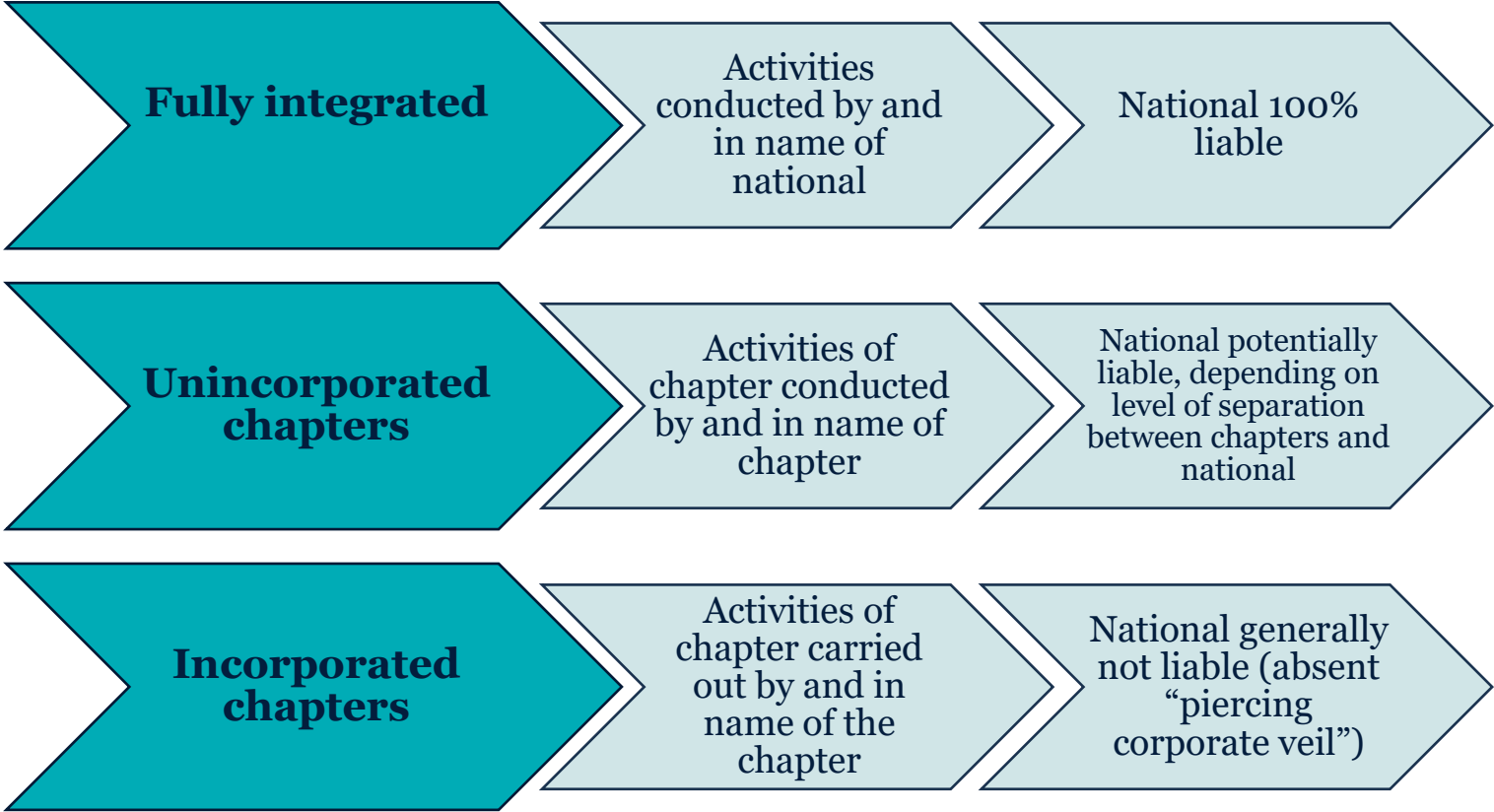
Common Chapter-National Relationships

Control/Autonomy Continuum



Common Chapter-National Relationships

Risk Profile of Common Affiliation Structures



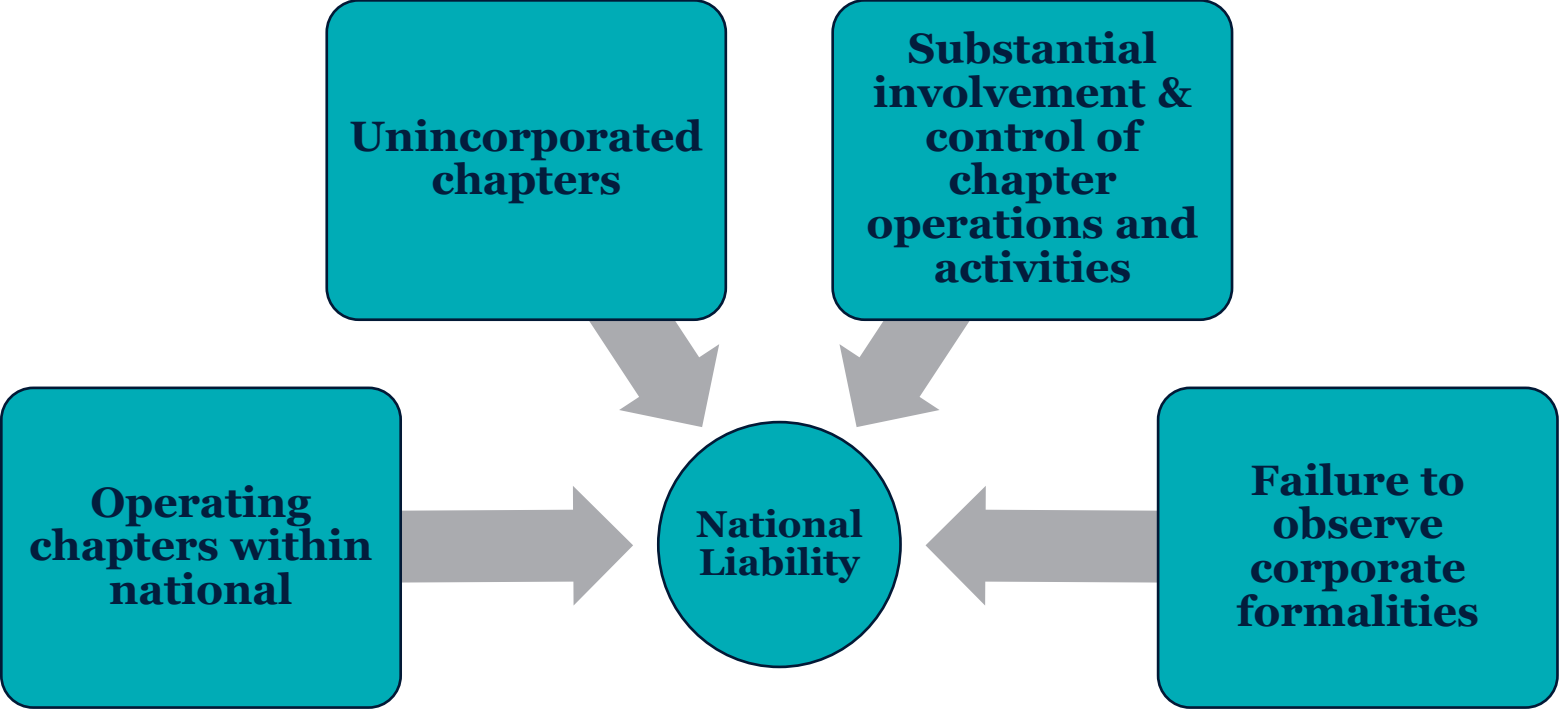
Key Legal Pitfalls: Liability

Examples:

- Injuries caused at event
- Breaching a contract
- Intellectual property infringement (e.g., using photo, playing music, or using materials without a proper license)

Key Legal Pitfalls: Liability

Attribution of liability from chapter activities to national



Key Legal Pitfalls: Protecting National's Intellectual Property

Names & Logos

- Common practice for chapter name to include national's name
- Disputes over use of name likely in the event of disaffiliation

Publications & Data

- Chapters often use national's membership list and other data
- Chapters collaborate with national on creating new IP (e.g., educational content, publications)
- Raises questions on ownership of IP and protection of IP

Key Legal Pitfalls: Governance Challenges

- Fiduciary duties
 - Overlapping directors on national and chapter boards
 - Chapter representatives on parent board
- Common governance structure requirements
 - What works for national might not be best for chapter
- Board engagement
 - Lack of turnover in board
- Common membership requirements
 - Qualifications
 - Termination
- Managing chapter status
 - Threshold for granting charter
 - Dispute resolution
 - Inactive or probation status
 - Disaffiliation
- Financial management
- Dues collection arrangements
- Internal controls at chapter level

Tax Exemption Issues

- Source of exemption
 - Federal: recognition by IRS obtained through individual application or group exemption
 - State:
 - Typically, but not always, tied to federal status
 - Either automatically granted or separate application to state tax agency required
- Type of exemption
 - Federal: Income tax
 - State: Income tax, and potentially state property, sales, and use taxes

Tax Exemption Issues

- Group exemption
 - For closely related organizations; supervision and control required
 - Evidence of exempt status is central organization's group determination letter with letter from central organization confirming participation
 - New applications on pause
- Independent recognition
 - Must apply for 501(c)(3)
 - May apply or self-declare for 501(c)(6)
 - Evidence of exempt status is IRS determination letter

Recent Group Exemption Changes

- Annual Group Exemption Information Update
 - After elimination of IRS-generated roster, central organizations must now take more proactive role in keeping status intact
- Proposed New Requirements (Notice 2020-36)
 - At least five subordinates
 - Matching 501(c) and public charity status type
 - Similar purposes/NTEE codes
 - Uniform governing instruments
 - Ability to remove
- Stay Tuned

Annual Tax Reporting

- Virtually all tax-exempt entities must e-file a Form 990-type return with the IRS each year. Some states require their own filings too.
- Parent can file a consolidated return for group exemption participants, **OR** subordinate files its own
- Harsh consequences:
 - Failure to file for three years results in automatic loss of tax-exempt status for all subordinates (if central fails to file) or for the subordinate (if they file their own)
 - Once auto-revoked, group exemption is lost and cannot be reclaimed

Reinstatement After Auto-Revocation

- Streamlined retroactive reinstatement
 - Must be eligible to file Form 990-EZ or 990-N for the revoked years
 - Cannot have lost status before
 - Submit new application and past due 990-EZ returns within 15 months of revocation
- Retroactive reinstatement
 - Submit new application
 - Establish reasonable cause
 - Within 15 months of revocation – for one of the three missed years
 - After 15 months – all three missed years
 - File all past due and required returns
- Application date reinstatement

Managing Chapter Relationships

Areas addressed by affiliation agreement, charter, policies/procedures

Define relationship

- Grant charter; ways to terminate charter
- Obligations to report to national (financial, programmatic)
- Set expectation that chapters will maintain tax-exempt/corporate status

Establishing expectations on programs

- Require common (or at least not inconsistent) mission and purposes
- Set expectations and parameters for chapter activities
- Support and other services to be provided by national to chapters

Establishing expectations on finances

- Allocation of revenues; fundraising requirements
- Dues collection arrangements
- Internal controls requirements (e.g., bank account)

Managing Chapter Relationships

Areas addressed by affiliation agreement, charter, policies/procedures

Trademark protection

- License name/logo
- Set rules on how chapter can use trademarks
- Right to review chapter's use of national's trademarks
- Trademark registration

IP protection

- License membership list
- Set rules on how chapter can use
- Establish who will own rights to content jointly created

Liability protection

- Require insurance (general liability, directors/officers, event)
- Indemnification
- Setting boundaries

Tips for Governing Documents

- Use model forms and try to avoid legalese
- Significant corporate events should require national organization's pre-approval:
 - Merger
 - Dissolution
 - Bylaws amendments
 - Transfer of all/substantially all assets
- Expressly limit activities to furthering national organization's tax-exempt purposes
- Retain right to revoke affiliation
- Need to tailor to state law, if incorporated

Tips for Good Subordinate Relationships

- Send filing reminders and require reporting by chapter leaders on organizational changes and tax filings to remain in good standing
- Have dedicated staff to guide chapter volunteers
- Regularly provide training for chapter leaders
- Coordinate events and activities
- Strike balance between self-governance and centralization

Questions?



George Constantine

Partner

+1 202.344.4790

geconstantine@Venable.com



Judith Kim

Counsel

+1 202.344.4309

jykim@Venable.com



Andrew Steinberg

Associate

+1 202.344.4202

alsteinberg@Venable.com

Save the Date!

April 14, 2022, 12:00 – 1:30 p.m. ET
Washington, DC / Webcast

VENABLE LLP



© 2022 Venable LLP.

This document is published by the law firm Venable LLP. It is not intended to provide legal advice or opinion. Such advice may only be given when related to specific fact situations that Venable has accepted an engagement as counsel to address.

VENABLE LLP