# SUMMARY OF ISSUES FOR AFFILIATED ORGANIZATIONS

ABA Section on Taxation Exempt Organization Committee Meeting
Friday, May 7, 2010, 3:00 p.m.

Most exempt organization practitioners understand the basic tasks of creating and operating two or more affiliated tax-exempt organizations: Separate incorporation for each, governance by separate boards of directors, separate applications for recognition of tax-exempt status, separate bank accounts and financial records, separate Forms 990, etc. Behind these relatively straightforward issues of corporate and tax law, however, lurk a host of other legal issues, not all of them immediately apparent. The following checklist summarizes some of the key concerns to help practitioners spot the issues and resolve them.

**Subsidy Issues**

Affiliation of one organization with another frequently involves common use of certain resources – employees, offices space, the services of vendors, etc. – which creates the risk that one organization may subsidize the other. If that subsidy supports activities the organization providing the subsidy is not permitted to support – a particular issue when the subsidy is coming from a 501(c)(3) with its ban on electioneering and restrictions on others – then such a subsidy creates problems. For example, 501(c)(3) subsidy of an affiliated 501(c)(4) engaged in activities that would be deemed political campaign intervention could jeopardize the 501(c)(3)'s tax-exempt status, or a 501(c)(3)'s significant subsidy of an affiliate could be an improper private benefit. Avoiding such problems typically involves careful valuation of the transactions between the organizations in an effort to achieve a fair-market-value exchange.

Here are a few particular problems in this area that frequently arise

- *Mailing lists*: Affiliated organizations need to understand that lists of members, donors, clients, voters, activists, etc. must be treated as assets, and their ownership, license to use, and allocation of costs to maintain must be addressed to avoid any improper subsidy. A 501(c)(4) that sends a fundraising appeal or a partisan political message to a list of donors owned by an affiliated 501(c)(3) must compensate the 501(c)(3) for the value of that list based on the fair-market value of the list. (Even with such compensation, there is a question about whether an organization is subsidizing its affiliated organization if it gives the affiliate access to a list while denying access to other organizations.)

- *Membership*: If both organizations have dues-paying members, there is often a desire to require or encourage individuals to join both organizations. The risk of subsidy occurs if there are significant advantages to joining one organization that therefore creates an incentive to join the other. For example, if only members of a 501(c)(3) organization are eligible for services offered by the 501(c)(3), favorably priced insurance, discounts from local merchants, etc., then requiring individuals to join an affiliated 501(c)(4) as a condition for joining the 501(c)(3) could be a 501(c)(3) subsidy of the 501(c)(4) unless the 501(c)(4) compensates the 501(c)(3) for the value of that incentive to join the 501(c)(4).

- *Marks and Goodwill*: A tax-exempt organization's name, logo, etc. are potentially valuable assets (whether or not the service marks have been registered) and there may be significant goodwill associated with the organization. When one or more new affiliated organizations are created with a clear connection to this history (e.g. the well-respected 501(c)(3) "Good Works Education Project" creating the 501(c)(4) "Good Works Action Fund," which creates, in turn the 527 "Good Works PAC") the 501(c)(3) has arguably subsidized the new entities. Fortunately, the IRS has suggested (albeit in a non-precedential document) that such a group of affiliated entities may have similar names. Ward L. Thomas and Judith E. Kindell, "Affiliations among Political, Lobbying, and Educational Organizations," *IRS Exempt Organizations Continuing Professional Education Technical Instruction Program 2000* at 262.

**Attribution Issues**

Affiliated organizations with similar names, closely related missions, and using common resources will often face the problem that communications or other activities of one organization are mistakenly attributed to the other. Mistaken attribution is a particular problem when the activity in question is one that puts the organization's tax-exempt status at risk, such as a when the endorsement of a candidate for public office by a 501(c)(6) is mistakenly attributed to an affiliated 501(c)(3). Some common situations in which this problem occurs include:

- *Websites*: The Internet has made it much easier for the public to be confused about the lines between affiliated organizations.

  Affiliated organizations that share a single website must be careful to avoid posting content that would put either of the organizations at risk or, at least, build the site in such a way that the distinction between the organizations is clear. (See, e.g., TAM 200908050, in which the IRS found that the organizations had failed to make the distinction clear.)

  While separate websites are preferred, especially when a 501(c)(3) is affiliated with another organization engaged in political activities, affiliated organizations must likewise be careful not to link to the affiliate's website in a way that suggests adoption of the problematic content. (See Rev. Rul. 2007-41 for a discussion of attribution and hyperlinks; see also the July 28, 2008 IRS Field Service Directive describing IRS enforcement policy not to pursue allegations of political campaign intervention based solely on a 501(c)(3)'s link to the home page of an affiliated entity even if the affiliate is engaged in political activity.)

  Sometimes only one organization has a website, while the affiliate does not. In those cases, make sure that the organization without a website does not list the other organization's website as its own on its Form 1023 or 1024, Form 990, letterhead, business cards, etc.

- *Media*: When affiliated organizations have similar names, the press is sometimes going to get it wrong. For example, when a 501(c)(4) associated with a prominent 501(c)(3) organization issues a press release endorsing a candidate for public office, it is possible that some of the media reporting the fact are going to attribute the endorsement to the 501(c)(3). Organizations should, of course, be careful to use the proper name, letterhead, etc. when making such communications. Whether or not the organizations should take steps to correct misattributions when they nonetheless occur should be determined on a case-by-case basis, weighing the prominence of the error, whether it suggests improper activity by one of the organization's, the likelihood that an attempt to correct would only serve to draw attention to the error, and other risk factors.

**Employment Issues**

Shared use of employees by different affiliated organizations potentially raises a number of employment law related issues:

- *Common Law Employees*: While organizations with reimbursement arrangements may assume that only one of the affiliated organizations actually has any employees, employees can be considered "common law" employees of multiple organizations if the organization exercises direction and control over them. The law looks beyond the form of the arrangement and analyzes the relationship between the organizations and the workers. Therefore, in many instances, employees whose services are shared among affiliated organizations, especially those employees working on program, will be the common law employees of all of the affiliated organizations for whom they provide services, with the resulting employment law obligations falling to each of the employers.

- *Federal Payroll Obligations:* A principal obligation of an employer is to pay salary, and withhold and remit federal taxes, Social Security and Medicare taxes, and, where applicable, pay federal unemployment tax (FUTA). Normally, each distinct employer has the separate responsibility to comply with these obligations for its own common law employees for that portion of salary attributable to employment with each organization. In some instances, however, one affiliated organization can instead have its affiliated organization handle these obligations on its behalf.

    - <u>Use of Common Paymaster for Shared Employees:</u> If two or more organizations are "related" within the meaning of the common paymaster regulations (a different definition from that used for defining "related" organizations for purposes of the Form 990) and both organizations employ one or more employees concurrently, one of the organizations may act as the "common paymaster" for the shared employees. The common paymaster can handle all of the disbursements of salary for the shared employees, perform all withholding and tax payment functions related to the shared employees, file all the information and tax returns associated with tax withholding and Social Security, Medicare, and FUTA payments, and issue a single W-2 for the employees. In addition, the total amount of taxes imposed on the salary of the shared employees is calculated as if there is a single employer so there is no duplicate tax burden, for example for Social Security taxes which otherwise are only paid up to a certain dollar amount of total compensation. The organization acting as the common paymaster must handle *all* of the payroll obligations for the shared employees, including those, such as FUTA (see below), that only apply to employment with one of the organizations.

- Use of Payroll Agent for Employees Working Only for the Other Organization: An affiliated organization can use a common paymaster only if the relevant employees are *shared* employees with the organization that is acting as common paymaster. Where certain employees will be working exclusively for the other organization, the first organization cannot function as the common paymaster for those employees. Instead, if the organizations want the first organization to handle various payroll related administrative functions for the other organization, the first organization can act as the authorized payroll agent of the other organization.

- *State Payroll Obligations:* In addition to its federal payroll obligations, an employer has similar state obligations to withhold state taxes and pay state unemployment tax, if required. Some jurisdictions follow the federal approach and allow related corporations to use a common paymaster for shared employees. Other jurisdictions do not. In places where the common paymaster is not available, any affiliated organization which is a common law employer would separately be responsible for the payroll obligations for that portion of salary attributable to employment with each organization.

- *Unemployment taxes:* Section 501(c)(3) organizations are exempt from paying FUTA for their employees. 26 U.S.C. § 3306(c)(8). However, other types of tax-exempt affiliated organizations are not similarly exempt. Therefore, where an individual is a common law employee of an affiliated organization that is subject to FUTA, appropriate FUTA taxes must be paid on that part of the salary attributable to work for that organization. FUTA must be paid even if the section 501(c)(3) organization is acting as the common paymaster for the affiliated organizations. Depending on state law, affiliated organizations may have additional state unemployment tax obligations.

- *Employee Benefits:* In order for employees to receive various employee benefits, the relevant plans must cover employees of the employer or employers identified in the plan document. Where employees are shared or work only for the nonprimary organization, the affiliated organizations need to make sure that the relevant plans are written so as to provide benefits to employees of both organizations to ensure that the employees are fully covered. If the plans are only for one organization, time spent working for the other organization does not count for purposes of determining the number of hours required to participate and for other purposes as well.

  In addition, if an employer offers a section 403(b) plan as the pension plan for its employees, it is important to remember that only section 501(c)(3) organization employees can participate in a section 403(b) plan, and only salary attributable to working for the section 501(c)(3) organization counts for purposes of making contributions under the plan. For the common law employees of other types of organizations, a supplemental retirement plan may need to be offered to provide the same level of benefits.

  In many instances, employee benefit plans can be amended to cover more than one organization. If coverage of all of the affiliated organizations under the same plan is not possible (for example, it has at times been difficult to get a single prototype pension plan for more than one organization), then separate plans for the organizations may be required. If a carrier wants the affiliated organizations to make certain representations about their relationship in order to have the organizations covered under the same plan, be sure to understand what the representations mean and their implications for other aspects of the organization's relationship. For example, calling a section 501(c)(3) organization and a section 501(c)(4) organization that conducts political activity part of a "controlled" employer group is likely not desirable.

- *Joint Employment:* For purposes of various employment statutes, such as the Fair Labor Standards Act, the Family and Medical Leave Act, various nondiscrimination laws, and similar state statutes, affiliated organizations may be considered joint or integrated employers. Such a determination has implications for whether the laws are applicable to a particular organization and for determining liability (e.g., how many hours have been worked for calculating overtime).

**Leases**

Frequently only one of the affiliated organizations will be a party on a lease for the offices or other facilities occupied by both organizations. When negotiating such a lease, make sure that allowing the tenant's affiliate to use the premises will not constitute a prohibited sublease or assignment of the lease. One approach is to provide in the lease that use of the premises by any entity with which tenant shares a significant portion of staff and other resources (and naming any such affiliate if any already exist) shall not constitute a sublease, assignment, transfer, or encumbrance of lease.

**Lobbying Disclosure Laws**

Many 501(c)(3)s create affiliated 501(c)(4)s primarily to enable lobbying in excess of the limits on 501(c)(3) organizations (an approach endorsed in *Regan v. Taxation With Representation*, 461 U.S. 540 (1983)). The intersection of such affiliated organizations and the federal Lobbying Disclosure Act ("LDA") and similar lobbyist registration and reporting laws at the state and local level plays out in a variety of ways.

An organization is required to register under the LDA only if it meets certain threshold requirements, among them whether the organization employs a "lobbyist." To qualify as a lobbyist, an individual must be engaged in "lobbying activity" for at least 20% of the time she spends working for the organization. Note, however, that if the individual is employed by affiliated organizations, but only bills the time spent lobbying to the one of the organizations, then, arguably, more than 20% of her time working for that organization will be lobbying, even if the lobbying constitutes less than 20% of the total time she spends working for the affiliated organizations.

Another issue involves the restrictions under congressional ethics laws on organizations served by registered lobbyists. For example, such organizations are generally prohibited from paying for congressional travel and from making even token gifts to members of Congress and their staff. However, even if an organization is subject to these restrictions, its affiliated organization may not be (although there may still be restrictions on involvement by individuals who are registered lobbyists).

**"Charitable" Solicitation Registration**

Most exempt-organization practitioners are familiar with state (and local) laws requiring 501(c)(3)s soliciting charitable contributions in a jurisdiction to register (typically with the state attorney general). Practitioners should remember, however, that many of these laws are written broadly enough to require registration by 501(c)(4)s and other tax-exempt organizations soliciting non-charitable contributions, and registration by an affiliated 501(c)(3) does not cover solicitation by the other organization. Thus, joint solicitations by affiliates frequently require both organizations to register.

**Nonprofit Postal Permits**

Remember that each organization must apply separately for its own nonprofit postal permit. Not only does use of another organization's nonprofit postal permit violate U.S. Postal Service rules, but it would also potentially trigger the subsidy issues discussed above.

**Organizational Divergence**

In creating a new affiliated organization, it is also important to consider the risk that the affiliate might someday go its own way. Because affiliates are separate legal entities, there is the risk that the governing board of one might choose to take the organization in a different programmatic direction from that of an affiliated entity and split the two organizations. There are examples of affiliated organizations diverging in this way.

Organizations that desire to prevent this (or at least make it more difficult) have a variety of options, most of which are most easily pursued when the affiliate is initially created. Some options include:

- Creating the affiliate as a single-member entity, with the existing organization as that member;

- Giving the existing entity the power to appoint the board (or a majority of the board) of the new affiliate (and restricting the ability of the new organization to amend its governing documents without approval of the existing entity); and

- Ensuring that the existing entity controls the name and logo used by both organizations, and then licenses those marks to the affiliate (with the implicit threat that such license might be revoked).

**Form 990 Reporting Issues**

The thrust of the "Redesigned 990's" Part VII ("Compensation of [TDOKEs and High 5's]…") reporting is that an exempt organization must report not only the amounts of compensation it pays to its listed managers, but also the amounts those managers are paid by "related organizations," regardless of whether the latter's pay to the managers is for services provided to the filing organization.  The goal the IRS had in requiring disclosure of remuneration from both the filer and any and all of its “related organizations” was transparency with respect to the individuals’ *overall* pay, a transparency which in the past could only have been achieved by reviewing the Forms 990 of multiple organizations.

It is also the case that the redesigned 990’s Part VII requires filers to disclose the circumstances and report amounts of compensation (when they know the amounts) by which a listed manager is compensated by an un-“related organization” *for services that the manager provides to the filer*. (There is a “taxable organization volunteer exception” to this requirement, but for purposes of this presentation, we will assume that it does not apply.)

In light of these divergent Form 990 conventions, affiliated organizations need be cognizant that in order to properly prepare Forms 990 each organization will need determine the extent to which compensation paid by the others is required to be disclosed on its own filing. Furthermore, when an affiliated organization is a “related organization” of the filer, the total amount of *reportable compensation* (i.e., amounts shown on an individual’s W-2, Box 5 for the calendar year ending with or within the filer’s tax year or, for individuals treated as independent contractors, amounts shown on an individual’s Form 1099-MISC, Box 1) paid by the filer and to be reported as paid by that (and other) related organization(s) will be included in the *reportable compensation* thresholds by which non-Trustee/Director/Officers hold status as Key Employees or High 5’s.