

WEBSTER, CHAMBERLAIN & BEAN
1747 Pennsylvania Avenue, N.W., Suite 1000
Washington, D.C. 20006

(202) 785-9500

(202) 835-0243 (FAX)

(202) 835-0243 (FAX)

OVER SHEET

FACSIMILE COVER SHEET

TO: Kevin Corcoran

FAX #: 775-1587

FROM: Arthur L. Herold

DATE: May 28, 1997 **TIME:** 6:02 PM

CLIENT: NAHU

Total Number of Pages including cover page) 11

Sender: Barbara

Kevin -

Here's some information about the relationship of an association to its foundation. Let me know if you need anything more specific.



The information contained in this transmission is privileged and confidential. It is intended only for use of the individual or entity named above. If the reader of this message is not the intended recipient, you are hereby notified that any dissemination, distribution, or copy of this communication is strictly prohibited. If you received this communication in error, please notify us immediately by telephone. If there are any problems with this transmittal, please call Barbara at 202-785-9500. Thank you.

LAW OFFICES
WEBSTER, CHAMBERLAIN & BEAN
 1747 PENNSYLVANIA AVENUE, N.W.
 WASHINGTON, D.C. 20006
 (202) 785-9500
 FAX: (202) 835-0243

GEORGE D. WEBSTER
 J. COLEMAN BEAN
 ARTHUR L. HEROLD
 ALAN F. STE
 EDWARD D. COLEMAN
 BURNETT VAN KIRK
 FRANK M. NORTHAN
 GERARD P. PANARO
 JOHN W. HAZARD, JR.
 CHARLES H. WATKINS
 RUSSELL K. WEBSTER
 DAVID R. COCH
 THOMAS W. SMITH

OF COUNSEL
 CHARLES E. CHAMBERLAIN

January 25, 1993

Re: Legal Aspects of Relationships Between
and the Research Foundation

Dear _____:

As we discussed during our conference call on January 21 with _____, this letter reviews several legal aspects of the relationship between _____ and the Research Foundation ("the Foundation").

"Separateness" of _____ and the Research Foundation

The Internal Revenue Service has long recognized that a trade association may establish a controlled charitable foundation to conduct charitable, educational, and research programs in which the association is interested, using tax-deductible contributions, as well as financial and in-kind contributions from the association. Although §501(c)(3) of the Internal Revenue Code does not expressly address this issue, the provisions of §509(a)(3) of the Code recognize that some §501(c)(3) charities will be controlled by, or operated by or in connection with, a §501(c)(6) trade association. The Research Foundation is a §501(c)(3) organization recognized by the IRS as a §509(a)(3) charity.

This position is grounded in the recognition of the common law principle that corporations are to be treated as separate entities unless one corporation (the foundation) is so much a mere tool or instrument of the other (the association) that the association should be liable for the acts of the foundation, or

WEBSTER, CHAMBERLAIN & BEAN

January 25, 1993

Page 2

unless there is such confusion of identities as to defraud third parties. Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943); National Carbide Corporation v. Commissioner, 336 U.S. 422 (1949); Jabczynski v. Southern Pacific Memorial Hospitals, Inc., 579 P.2d 53, 59 (Ariz. 1978). The court ruled in National Carbide that a corporation will not be ignored as a taxable entity merely because it is wholly owned by a single stockholder. "Complete ownership of the corporation, and the control primarily dependent upon such ownership ... are not of significance in determining taxability." National Carbide, 336 U.S. at 429. Of course, this means that a trade association's authority to appoint all of the directors of a related foundation would, in itself, have no bearing on the tax-exempt status of either the association or the foundation.

Facts and Circumstances

Whether or not the separate entities of an association and its related foundation will be respected always depends on a review of all the relevant facts and circumstances. No single fact (such as transfers at no cost) will necessarily cause the corporate veil to be pierced, nor, conversely, will any one fact assure the separateness of the entities. In addition, the significance accorded each fact may vary from case to case. Set forth below is a brief discussion of each of the relevant factors that may be considered by the courts and the IRS:

1. Maintenance of the corporate formalities. Establishment and maintenance of a corporation requires the filing of articles of incorporation, holding of meetings of directors, adoption of bylaws and other resolutions necessary to the conduct of the corporation's business, the filing of annual reports and tax returns, and doing business in the corporate name.
2. Independent judgment by directors on behalf of the corporation. This fact is accorded significant weight by the authorities, and is probably the most significant factor to be evaluated. The board of directors or trustees of each corporation should meet frequently enough, considering all the facts and circumstances, to effectively oversee the management of the corporation, and should be guided by their best judgment of how the corporation should be governed, not merely by the directives of anyone else.

WEBSTER, CHAMBERLAIN & BEAN

January 25, 1993

Page 4

However, in order to provide a clearer basis for the payments from the Foundation to , we recommend that a comprehensive agreement be developed and executed by both parties, and timely amended thereafter. Of course, we would be happy to work with you and the Joint Task Force to develop this agreement.

Foundation Activities

Because the Foundation is exempt under §501(c)(3), it may not pursue any substantial purposes other than educational, research, and other charitable purposes. Thus, in contrast to , it may not, except incidentally to its own purposes, promote the common business interests of 's members or other . Of course, the Foundation also may engage in activities to influence legislation to only a limited extent, and is absolutely prohibited from participating or intervening in any political campaign, including endorsing or opposing any candidate.

These restrictions require that the Foundation not make any payments to the , except under an agreement that will use those funds to conduct activities that accomplish the Foundation's purposes. Thus, the Foundation may pay for services required for the management and administration of the Foundation, as well as for direct and allocable indirect expenses of educational or research programs actually conducted by the Foundation. The Foundation should also receive from , perhaps with each invoice, a more detailed accounting supporting the invoiced amount. This would also document the amount of 's in-kind contribution of management services to the Foundation.

In contrast, no similar restrictions apply to payments from the Foundation (including 's in-kind contribution of services), provided the Foundation uses those funds or services to accomplish its exempt purposes.

Sale of Merchandise

You explained that the Foundation has some educational materials that it wishes to sell. The Foundation has asked to promote and sell these materials. The price for the materials is established by the Foundation and the Foundation receives all monies from the sale by . However, the Foundation pays a reasonable fee for the services renders in connection with

WEBSTER, CHAMBERLAIN & BEAN

January 25, 1993

Page 5

selling the Foundation's merchandise, based on the amount of time the staff devotes to this effort. The Foundation's payment of for its services in selling the Foundation's products is an appropriate "fee for service" arrangement between the two organizations.

Personnel Reporting Relationship

As discussed above, we do not believe that any risk to the Foundation's exemption arises from the Foundation's sharing of employees with , or from those employees being paid by even though they are providing services, principally or otherwise, to the Foundation.

Based on our experience with many other associations that have established foundations, the most common practice is for the chief staff official, e.g., the president, of the association to also be the chief staff official, e.g., the executive director, of the foundation. In nearly all cases, that individual then has another staff person who is actually responsible for the day-to-day conduct of the foundation's activities, and who reports to the chief staff official. He or she, in turn, then reports, as appropriate, to the board of directors of the association and the board of trustees of the foundation.

This organizational form has the following advantages:

1. The foundation's board-management-staff structure, reporting relationships, and accountability are parallel to those of the association.
2. Because the two entities share the same CEO, who is responsible for management of both corporations, there is little opportunity for significant organizational conflicts to arise or persist. The CEO tends to harmonize the activities of the two entities.
3. When organizational conflicts do arise, the CEO is immediately aware of them and can take steps to resolve them himself or to quickly seek resolution by the two boards. This naturally limits the scope and frequency of conflict, and minimizes any resulting dilution of resources and programs.

WEBSTER, CHAMBERLAIN & BEAN

January 25, 1993

Page 6

... we trust that this information will be helpful to the Joint Task Force. Of course, we would be happy to answer any questions that arise at the meeting in Phoenix, and we look forward to continuing to work with you on this matter. Should you have any questions, or want to discuss these issues further, please do not hesitate to contact us.

Yours very truly,



Arthur L. Herold



Charles M. Watkins

ALH/CMW/bkd

Enclosure

MEMORANDUM

TO:

FROM: Arthur L. Herold and Charles M. Watkins

DATE: August 16, 1993

RE: The Research Foundation: "Public Charity" Status
Under Section 509(a)(3) of the Internal Revenue Code

The Internal Revenue Code defines two subsets of §501(c)(3) organizations: (1) "private foundations" and (2) "public charities." An organization is deemed to be a private foundation unless it satisfies one of the descriptions of a public charity set forth in §509(a) of the Code.

Private Foundations

"Private foundations" are typically financially dependent on one (or a few) donors of large amounts, or on investment income. For this reason, they are considered not to be accountable in any meaningful way to "the public," and are subject to significant

regulation of their management and activities. The typical private foundation is a corporate or family foundation.

Public Charities: "Public Support" tests

In contrast, "public charities" (the term does not appear in the Code) must receive either--

(1) at least one-third of their support from contributions from the public (disregarding any contribution to the extent it exceeds 2% of all support) and governmental agencies (§509(a)(1)); or

(2) at least one-third of their revenues from program services (other than from certain "disqualified persons") and less than one-third of their revenue from investment income (§509(a)(2)).

These tests, based on a four-year rolling average, are applied annually to determine whether the charity continues to be a public charity.

Public Charities: "Supporting Organizations"

A §501(c)(3) organization may also qualify as a public charity if it is "operated, supervised, or controlled by or in connection with" a §501(c)(6) association (such as) if the association

receives at least one-third of its revenue from dues and program service revenue and less than one-third of its support from investment income. A public charity that is a "supporting organization" is not subject to either of the annual "public support" tests discussed above.

"Operated, Supervised, or Controlled By"

Treas. Reg. §1.509(a)-4(g)(1) states that one organization is "operated, supervised or controlled by" another if the "parent" has "a substantial degree of direction over the policies, programs, and activities" of the "subsidiary." This requirement is satisfied if the governing body or members of the "parent" elect a majority of the officers, directors, or trustees of the "subsidiary."

presently "controls" The Research Foundation because all of the trustees of the Foundation must be elected or "ratified" by the Executive Board or members of before they may serve as trustees. (That the election by the Executive Board or members may be for an office other than trustee of the Foundation, e.g., Chairman of the Executive Board or President, is not material.)

Conclusion

~ In light of these rules, control of the Foundation by and a close working relationship between the Foundation and is anticipated and encouraged by the Internal Revenue Code and will not jeopardize either the Foundation's exemption under §501(c)(3) or 's. exemption under §501(c)(6). Of course, these rules also presuppose that (as discussed in our letter of January 25, 1993 to) the Foundation's assets are used exclusively to advance its educational and charitable purposes. Accordingly, there is no tax-related obstacle to the Executive Board exercising a more active role in the election and ratification of trustees of the Foundation.