



Social Enterprise Part 2: What Can §501(c)(3)s Do?

Robyn Miller
Corporate/Tax Counsel, Pro Bono Partnership of Atlanta

May 4, 2016

Mission of Pro Bono Partnership of Atlanta:

To provide free legal assistance to community-based nonprofits that serve low-income or disadvantaged individuals. We match eligible organizations with volunteer lawyers from the leading corporations and law firms in Atlanta who can assist nonprofits with their business law matters.

Pro Bono Partnership of Atlanta Eligibility & Other Information

- In order to be a client of Pro Bono Partnership of Atlanta, an organization must:
 - ✓ Be a 501(c)(3) nonprofit organization.
 - ✓ Be located in or serve the greater Atlanta area.
 - ✓ Serve low-income or disadvantaged individuals.
 - ✓ Be unable to afford legal services.
- *Visit us on the web at www.pbpatl.org*
- Host free monthly webinars on legal topics for nonprofits
 - ✓ To view upcoming webinars or workshops, visit the Workshops Page on our website

Legal Information:

- This workshop presents general guidelines for Georgia nonprofit organizations and should not be construed as legal advice. Always consult an attorney to address your particular situation.
- All rights reserved. No further use, copying, dissemination, distribution or publication is permitted without express written permission of Pro Bono Partnership of Atlanta.

Summary of Part 1

- Definition of Social Enterprise
- Different corporate structures
 - ✓ For-Profit Business
 - ✓ L3C
 - ✓ Public Benefit Corporation
 - ✓ Social Benefit Corporation
 - ✓ §501(c)(3) Nonprofit Corporations
- Some structures better than others depending on type of and goals for activity.

What is Social Enterprise?

- “The use of market-based strategies to solve social problems”
 - ✓ Selling a good or service and using income to do good
 - ✓ Can be non-profit or for-profit
 - ✓ Can be tax-exempt or not
- FOCUS THIS WEBCAST: §501(c)(3) nonprofit corporations

Considerations for 501(c)(3)s Conducting Social Enterprise Activities

- Social enterprise activities involve the sale of goods or services that may or may not be in furtherance of §501(c)(3)'s charitable purpose/mission
- Under IRC §501(c)(3)'s operational test, an organization's activities *must (exclusively)* further its charitable purpose
- Potential legal consequences for §501(c)(3)'s engaging in business activity include loss of tax exempt status, taxation

Jeopardizing Tax-Exempt Status

- 501(c)(3) organizations cannot engage in unrelated business activities that are substantial in relation to their charitable purpose
 - ✓ What is “unrelated”?
 - “making money for our organization” doesn’t count as “related”
 - ✓ What is “substantial”?

Unrelated Business Taxable Income

➤ The Test:

- ✓ Trade or business
 - Activity carried on for production of income from sale of goods or services
 - ✓ Regularly carried on; and
 - Regularity and continuity
 - Carried on in same way as a comparable commercial activity
 - ✓ Not substantially related to mission
 - No causal relationship to exempt purpose
- *Note: The mere fact that the income produced will be used to carry out the mission is not a sufficient causal relationship. The activity must be related.*

Modifications & Exclusions to UBTI

- Volunteers
- Training Program
- Contributed Property
- Passive Income
 - ✓ Dividends, Interest, Annuities, Royalties
 - Cause Marketing Royalty
 - For-Profit Subsidiary Dividend
- Rents from Real Property
- Sale of Property
 - ✓ e.g. Capital gains
 - Note: Does not apply to inventory or property held in ordinary course of business



Questions 501(c)(3)'s Should Ask

- **Selling Merchandise/Property**
 - ✓ What is being sold?
 - ✓ Who is selling/purchasing?
 - ✓ What services are provided?
 - ✓ Who is providing the services?

- **Rental Property**
 - ✓ Debt financed property?
 - ✓ Provide services?



Unrelated Business Income – Other Resources

- *View a webcast on unrelated business income:*
 - ✓ <http://www.pbpatl.org/resources/unrelated-business-income>
- *Read the following articles or publications:*
 - ✓ <http://www.pbpatl.org/wp-content/uploads/2011/12/ubit1.pdf>
 - ✓ <http://www.pbpatl.org/wp-content/uploads/2011/12/AlternativeFundraising1.pdf>

Creative Solutions for Nonprofits

- Some approaches to avoiding potential loss of tax-exempt status and UBTI include:
 - Training Programs
 - Cause Marketing
 - Sponsorships
 - For-profit subsidiaries

Training Programs

- “Clear and distinct causal relationship” between the work activity & training of individuals.
- Scale of training program must not be larger than what is reasonably necessary to accomplish the organization’s charitable purpose.
- Training programs = Related to Mission & NO UBTI had combination of the following (plus 2 bullets above):
 - ✓ Program clients/trainees are the primary employees, except for individuals providing training and supervision of the program participants/trainees
 - ✓ All work involved in the business activity is performed by the program clients/trainees and those who provide training and supervision
 - ✓ Work or employment in program is transitional employment to gain certain skills or competencies in accordance with the program objectives
 - ✓ The program clients/trainees may only work in the program’s employment for a limited period of time
 - ✓ Any net profits gained from the commercial business activity training program operations are applied toward the organization and its mission

Cause Marketing Central Elements:

- For Profit Business and §501(c)(3) Cause/Mission
- A specific campaign or promotion
- A “marketing” approach to charitable giving:
 - “**Company A does well by doing good for Charity B**”
- Payments to charity generally structured as royalties for the use of name and logo
- Formats:
 - ✓ Product Partnership (save lids to save lives)
 - ✓ Product Certification (heart check)
 - ✓ Product Branding (product red)
(unique cause brand licensed to partner cos)



Qualified Corporate Sponsorship

- Quid pro quo – Payment to charity in exchange for recognition
- Acknowledge vs. Advertising (Advertising = UBTI)
- Logos and Trademarks
- Corporate Sponsorship Rules
 - ✓ Acknowledgement of Sponsor: name & logo
 - No statements endorsing products
 - If website/email acknowledgement, no language endorsing or inducing site visitors to purchase or use sponsor's products
 - ✓ No other “substantial return benefit”
 - Substantial return benefit could = substantial private benefit = loss of exemption
 - Insubstantial value = all goods and services received from the charity by the sponsor must NOT exceed 2% of sponsorship payment for year



For-Profit Subsidiaries

- Put business in separate corporation or LLC that is owned by the 501(c)(3) and treated as C-Corp for tax purposes.
- Income from for-profit business go to 501(c)(3) as dividends = passive income = no UBTI
- Four Important Factors:
 - ✓ Director/Officer/Employee overlap – (c)(3) should not have complete control over subsidiary
 - ✓ (c)(3) Parent doesn't participate in day-to-day management of subsidiary
 - ✓ Arm's Length transactions between parent and subsidiary
 - ✓ Bona fide business purpose for taxable subsidiary

Other Complex Creative Solutions for Nonprofits

- Some complex and sophisticated approaches to avoiding potential loss of tax-exempt status and UBIT include:
 - Partnerships with for-profits
 - L3Cs
 - Separate Public benefit corporations

Ways to Mitigate Risks

- Purpose – Broaden scope of purpose to include more activity
- Target the Activity – If possible, conduct activities so as not to be “regularly carried on”
- Generate Revenue Under an Exclusion/Modification – Several categories of non-taxable “unrelated” business income sources: dividends, interest, rent royalties, volunteer labor, donated merchandise, training program
- Use a taxable subsidiary – When “substantial” bar exceeded a sub preserves the tax exempt status of the parent

For More Information:

If you would like more information about the services of Pro Bono Partnership of Atlanta, contact us at:

Phone: 404-407-5088

Fax: 404-853-8806

Info@pbpatl.org

www.pbpatl.org