Nonprofit Knowledge: Joint Ventures Involving Tax-Exempt Organizations (Part 2)

Nonprofit Organizations

The [first article](#) of this two-part series discussed the legal structure of ancillary joint ventures between a tax-exempt organization and for-profit entities. This article will provide an overview of agreement terms and organizational policies that would support the implementation of such a venture.

When a tax-exempt organization and for-profit entity are entering into an ancillary joint venture, they should use an agreement — whether a joint venture contract or an operating agreement for a joint venture LLC — that protects the nonprofit's tax-exempt status.

Any agreement should be approved by the tax-exempt organization's governing board prior to execution and align with any organizational joint venture policies (which should also be approved by the board).

To ensure the nonprofit's tax-exempt status is not put in jeopardy, a joint venture must be closely managed by nonprofit leadership with knowledge of the risks and objectives of the venture.

Key joint venture agreement and policy features

Include these features in a joint venture agreement and organizational joint venture policies:

- The product, services, or licenses provided through the venture must be substantially related to the nonprofit organization's tax-exempt purpose to mitigate the risk of the venture being considered an unrelated activity
- The nonprofit must maintain control over key decisions of the venture to assure that it furthers the charitable mission, including providing the nonprofit with a majority vote or veto power if a jointly held entity is formed.

- Measures to preserve an arm's length relationship that sufficiently prevent impermissible private inurement.
- The nonprofit receives at least 50 percent of the joint venture profits even if the nonprofit does not contribute a proportionate amount to the joint venture.

After an agreement is signed, the nonprofit board or other leadership should have a regular review of the joint venture to ensure it continues to operate within the parameters of the joint venture policy and the mission of the organization.

Separate entity operating agreement

It is common with ancillary joint ventures for the nonprofit and for-profit to set up a separate entity to house the joint venture, such as a limited liability company. This separate entity can provide additional liability protection for both joint venturers.

The operating agreement for the new entity would include additional provisions, that should also be in the nonprofits joint venture policies, such as:

Governance provisions

- The nonprofit and the for-profit have a shared governance structure that gives the nonprofit control over the joint venture's mission objectives to reflect the tax-exempt purpose of the nonprofit and ensure that the mission purpose of the joint venture overrides the duty to financially benefit the for-profit venture. (The for-profit partner may control logistical or technical aspects of the venture's activities.)

- Set out who has responsibility and authority to participate in governance and reserving some decisions for approval by the board of directors, such as investments or a certain size or scope change.

- Require decisions of the governing body of the venture, even with contractual-only ventures, are documented and identify who is authorized to act and speak on behalf of the joint venture.

Financial provisions

- Require financial statements on a regular schedule.

- Investment determinations must be made consistently for funding or other assets. While valuation of an investment of intellectual property can be difficult in speculative circumstance, it is important for a nonprofit to develop a reasonable basis for the investment and assure it can be recovered, including derivative property, after the joint venture is terminated.

- Describe the method of how financial risks and rewards will be shared proportionally.

- Prohibit assets belonging of the nonprofit or the joint venture to be used to provide an impermissible benefit to any private individual or a for-profit entity.

- Any compensation decisions must be approved by the nonprofit to assure compliance with Section 4958 of the Internal Revenue Code intermediate sanction rules to avoid excise tax on excess benefits of disqualified persons.

- A method must be set out for vetting potential conflict of interests within the tax-exempt organization to prevent prohibited private inurement.
- Clarify financial controls and transparency among the venture participants with acknowledgment of the public disclosure of any income pass-through to the nonprofit that is reportable on the IRS Form 990 and the entity listed on Schedule R.
- All returns of capital, allocations, and distributions of the joint venture's earnings are at a minimum proportional to the nonprofit's ownership interests in and contributions to the joint venture.

Termination provisions

- Include sufficient safety valves for the tax-exempt organization to protect its mission and reasonably easy methods to exit the joint venture at its discretion if the mission is endangered or other policies are violated.

An ancillary joint venture can provide significant value for a tax-exempt organization, such as providing a vehicle for development of innovation that directly serves a trade association's members, providing resources for marketing services to local governments that scales a charity's mission, or increasing income while easing delivery of licensing content to professionals in an association's profession. With strong operating controls, a nonprofit organization can expand its scope without exposing itself to excessive risk.

[Anita Drummond](#)

Member

Outside GC LLC

Anita Drummond is a member and general counsel of Outside GC. She has been in private practice, general counsel of ChildFund International, USA, an organization working in 20+ countries, assistant general counsel at the American Cancer Society and The Nature Conservancy, and director of Legal Affairs at a trade association during her career. She specializes in corporate, charity, tax exemption, political, and social enterprise law in the United States and abroad. She is a member of the ACC Nonprofit Organization Network.

Lakshmi Sarma Ramani

Member

Outside GC LLC

Lakshmi Sarma Ramani was the general counsel of the National Association for the Education of Young Children and senior attorney at The Nature Conservancy. She is currently a member of the firm at Outside GC LLC where she is the outside general counsel to multiple nonprofit organizations.