Nonprofit 411:

Joint Ventures With For-Profits- Four Things You Need To Know

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Your organization might consider a joint venture with a for-profit for a variety of reasons. Sometimes a nonprofit and for-profit wish to exchange services. Often, a nonprofit organization seeks to obtain capital, staff and/or expertise from a for-profit in order to provide services to third parties.

There are several ways to structure a joint venture:

- Contractual arrangements are appropriate when the joint venture has a limited purpose, involves only two parties, and has a limited term.
- Limited liability company (LLC) and partnership arrangements are used for more complex transactions. Their tax status is similar, but LLC's provide more flexibility. The members of an LLC may have different rights with respect to voting, income, and distributions upon sale or liquidation, as well as different obligations to the joint venture.
- Corporate arrangements are the least common, but might be used if the venture expects to go public. Tax exempt organizations also may establish for-profit subsidiaries to insulate themselves from the unrelated business activities of the subsidiary.

Although joint ventures with for-profits offer many rewards, there is a minefield of potential issues to consider. Your organization risks losing its tax exempt status and your board members also risk penalties if joint ventures are not carefully structured. **It's critical for nonprofit organizations to work with counsel when entering into joint ventures, and to consider the following:**

1. Your organization must protect its tax exempt status. Tax exempt organizations may not permit their earnings to inure to insiders (directors, officers and key employees), although they may pay insiders reasonable compensation for goods and services. Also, a substantial portion of a nonprofit's activities may not benefit a private individual or for-profit organization. The Internal Revenue Service has provided guidance as to when "whole-entity" and ancillary joint ventures are permitted.
2. Your board members must consider their federal and state law obligations. Board members may be subject to federal tax penalties if the board approves a joint venture that provides for a compensation arrangement or business transaction with insiders that exceeds fair market value. Under state law, board members owe a duty of care and duty of loyalty, and are responsible for the use of charitable assets. The duty of care requires the board to consider fair market value considerations of a joint

venture. The duty of loyalty requires the board to avoid conflicts of interest. Board members must also ensure appropriate use of charitable assets. Notice to the Attorney General may be required before entering into a joint venture.

3. Your organization must review all legal requirements triggered by a proposed joint venture. For example, if a joint venture's use of bond-financed property is considered a "private business use," the bonds may become taxable. Under state law, a health care joint venture may require prior notice to the Massachusetts Health Policy Commission.
4. A nonprofit organization which engages in a joint venture will be subject to new disclosure requirements in its IRS Form 990: specifically whether it has a joint venture policy; and whether any joint ventures are with related persons.

Joint ventures can open up new worlds for your organization, but care must be taken to realize the full benefits and mitigate the risks. Working closely with counsel, you can ensure that your organization enters into and maintains the joint venture in a manner consistent with its tax exempt status and mission.

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