



Expansion: Related Organizations

A notable feature of the expanded Form 990 is its eliciting of a great deal of information on payments by related organizations to personnel connected with the filer and transactions with related organizations. This sort of information was elicited in the Forms 990 issued in the years just preceding its expansion in 2008, but the expanded Form 990 adds many more questions regarding related organizations. We believe that these additions derive from the IRS's concern about the use of related organizations for questionable purposes. For example, a related organization might be used to pay an employee of the filer to avoid having to disclose on the filer's Form 990 the full extent of the compensation s/he had received for performing services for the filer. The reader should then be alert that when the filer has relations with a related organization there may be an issue worth pursuing. As noted in the Introduction, because in the vast number of cases filers are not related to other organizations, this topic is covered here.

How do you check to see whether the filer is related to another organization? First you look at Lines 33-37 in Part IV on page 4 of the Form 990. In virtually every case where there is such a relationship, the filer is instructed to complete certain parts of Schedule R. We explain Schedule R below. The principal line is Line 34, which asks whether the filer was related to any tax-exempt or taxable entity. If the answer is "Yes," the filer is instructed to complete Schedule R, Parts II, III, IV and Part V, line 1. The other lines refer to somewhat technical and rare situations and shall now only be briefly commented on.

Line 33 relates to disregarded entities, entities such as LLCs that are part of the filer's operation, in effect divisions or branches, that are treated as separate organizations for state law purposes (e.g., liability claims) but as part of the filer for Federal income tax purposes. Information on these entities would be found at Part I of Schedule R.

Line 35 relates to controlled entities described by section 512(b)(13) of the Code. Section 512(b)(13) entities are usually subsidiaries of the filer that conduct unrelated or taxable business activities and section 512(b)(13) eliminates the possibility of avoiding taxation by the controlled entity making certain deductible payments to its parent. Information on these entities would be found at Part V of Schedule R.

Line 36 relates to transfers by the filer to an exempt non-charitable related organization. This usually involves transfers to certain entities that engage in political activity (e.g., section 527 organizations). Information on these entities would be found at Part V of Schedule R.

Line 37 asks whether the filer conducted more than 5% of its activities through an entity that is *not* a related organization and that is treated as a partnership for federal income tax purposes. Typically this refers to joint ventures that are conducted for unrelated business income or to engage in political activity. Information on these entities would be found at Part VI of Schedule R.

So what are related organizations? First we will consider the case where the two organizations are nonprofit organizations. There are three categories of related organizations.

1. If the filer stands in a parent/subsidiary relationship to another organization, they are related organizations. The filer might be the parent or the subsidiary. In a parent/subsidiary relationship, the parent has the power to elect or appoint a majority of the board of its subsidiary. (Even if the parent lacks this power, if a majority of the directors of the subsidiary are employees or agents of the parent, it will be a parent/subsidiary relationship.)
2. If the filer stands in a brother/sister relationship to another organization, they are related organizations. Here the two organizations are controlled by the same persons, that is, the same persons constitute a majority of the directors of both organizations.
3. Finally, if the filer stands in a supporting/supported relationship to another organization, they are related organizations. In this relationship the filer under section 509(a)(3) is either a supporting organization of the other organization (the supported organization) or the filer under section 509(a)(3) is a supported organization of the other organization (the supporting

organization). The specific rules under section 509(a)(3) that determine whether a supporting/supported relationship exists are detailed and quite complicated. Suffice it to say that the supporting organization must provide the supported organization with significant support that helps the supported organization carry out its charitable purposes and the supported organization must have sufficient control over the supporting organization.

We turn now to the case where the other organization is a for-profit entity. (Remember the filer will always be a nonprofit organization.) Here are the principal examples of related organizations in this context. The filer and such other organization will be related organizations if, in the case where the other organization is a corporation, the filer owns more than 50% of the stock (by voting power or value) of the corporation. If the other organization is a partnership, the filer and such other organization will be related organizations if the filer has an ownership interest of more than 50% of the profits or capital interest in the partnership.¹

If the filer is a related organization with another tax-exempt organization, it must complete Part II of Schedule R, by providing such information as the name of the other organization, its primary activity and its public charity status.² If the filer is a related organization with another taxable organization it must complete Parts III (relating to taxable partnerships) or IV (relating to taxable corporations or trusts), as appropriate. These Parts collect information similar to Part II and in addition include a column for share of total income.³ These parts, which must be completed whether or not the filer had transactions with the related organization in question, may be of interest in

¹ Similarly if the filer has an ownership interest of more than 50% of the profits or capital interest in a limited liability company (LLC) treated as a partnership under federal tax law, the filer and the LLC will be related organizations. In addition, if the filer is the managing partner in a partnership or LLC which has three or fewer managing partners (regardless of which partner has the most actual control), the filer and the other entity will be related organizations. Likewise if the filer is the general partner in a limited partnership which has three or fewer general partners (regardless of which partner has the most actual control), the filer and the other entity will be related organizations. If the filer is the sole member of a disregarded entity, it and the disregarded entity will be related organizations. (See the discussion of Line 33 above for a description of a disregarded entity.) Finally, if the filer has more than 50% ownership interest in a trust, it and the trust will be related organizations.

² See Chapter 9.

³ Part I elicits information on disregarded entities and Part VI information on unrelated organizations treated as partnerships.

themselves, but it may be in Part V which reports on transactions with related organizations where the real interest will lie. Line 1 lists 18 different kinds of transactions (e.g., loans, lease of facilities, performance of service, etc.). The filer is required to answer "Yes" if it had any such transaction with any entity listed in Parts II, III, or IV. If the answer is "Yes" and it relates to a transaction with a related organization that is a section 512(b)(13) controlled entity or a non-501(c)(3) tax-exempt organization, the filer must complete Line 2, which asks for the name of the organization involved and the type and amount of the transaction.⁴ The reader should realize that the IRS may be looking at this Schedule and Part V, and if anything seems to be not quite right, the reader may want to inquire further.

As suggested at the outset, perhaps the transaction that may be of most interest is that where a related organization provides a key employee or one of the filer's highly paid employees with compensation in addition to the compensation provided by the filer.

Part VII (Compensation of Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees) of the core Form 990 on page 7 is where you would look to see if any such payments transpired. See Chapter 6 for a full explanation of Part VII and compensation issues. Part VII Section A requires the filer to report the names and compensation of key employees. Section A also elicits such information on officers, directors and trustees. As explained in Chapter 6, most directors and trustees do not get paid for their service and officers are either board members who don't get paid or employees who do get paid.

Column E⁵ elicits information on reportable compensation from related organizations paid to such individuals. Part VII also requires the filer to report the names and compensation of the filer's five highest

⁴ That Line 2 is limited in its scope to 512(b)(13) controlled entities and non-501(c)(3) tax-exempt organizations is not immediately evident from a reading of the beginning line of Line 2 which states in part: "If the answer to any of the above is "Yes," see the instructions for information on who must complete this line" The instructions make it clear that Line 2 is limited to 512(b)(13) controlled entities and non-501(c)(3) tax-exempt organizations. See the text above on Lines 35 and 36 for an idea of what 512(b)(13) controlled entities and non-501(c)(3) tax-exempt organizations are.

⁵ As explained in Chapter 6, Section A of Part VII elicits information on compensation in six columns. For example, column A is where the name and title of the individual in question would be listed, column B the average number of hours a week s/he works and, as noted in the text, column E reports the reportable compensation paid by a related organization to the individual in question.

compensated employees (other than key employees) who received reportable compensation of more than \$100,000 from the filer and any related organizations. Again, any compensation from a related organization paid to such employees would be reported at column E. Compensation payments to employees of nonprofits from related organizations are rare. Such payments may flag an inappropriate transaction. Where a reader sees such payments reported, s/he may want to find out more about them.