

Morgan Lewis

MEMORANDUM

TO: Sandra Spector
David Frolio

FROM: Celia Roady
Kimberly Eney

DATE: DRAFT February 8, 2018

SUBJECT: Options for New Organization to Conduct IETF Administrative Support Activities

The Internet Engineering Task Force (“IETF”) is a project of the Internet Society (“ISOC”), a 501(c)(3) charity, that focuses on producing high quality technical standards documents that ultimately make the Internet work better. You’ve asked us to outline the options for retaining IETF’s administrative support activities within ISOC or transferring them to a new organization. This memorandum outlines the following options: (1) creating a new 501(c)(3) organization that qualifies as a 509(a)(1) public charity, which offers substantial independence from ISOC but requires fundraising; (2) creating a new 501(c)(3) organization that qualifies as a Type I supporting organization, which requires ISOC’s involvement in its governance but does not require fundraising; (3) creating a limited liability company (“LLC”) that is a disregarded entity of ISOC, which requires ISOC’s involvement in its governance but does not require fundraising and also results in fewer administrative burdens because it isn’t treated as a separate entity from ISOC for most federal tax purposes; and (4) continuing to treat IETF administrative support activities as ISOC activities without forming a separate legal entity.

I. Option 1: New 501(c)(3) that Qualifies as a 509(a)(1) Public Charity

A. Basic Structure

- Form a new 501(c)(3) organization that qualifies as a 509(a)(1) public charity.
- Mission can be distinct from ISOC’s mission, and it can engage in a wide range of activities.
- Can have members that are not ISOC members.

B. Governance; Independence from ISOC

- Offers flexibility regarding ISOC’s level of involvement in governance (e.g., ISOC can appoint all directors, a minimum number of directors, no directors, etc.).
- The board can perform all of the actions that are typical of a board, including hiring, evaluating, and firing the executive director and approving the annual budget.
- ISOC generally will not be liable for the corporation’s debts and obligations.

C. Finances and Fundraising

- Can have a separate bank account.
- Can receive contributions directly, which may impact ISOC's public support calculation.
- Must meet a public support test requiring at least one-third "public support" or at least 10% "public support" so long as it meets some additional facts and circumstances (e.g., its board is broadly representative of the public, engages in active fundraising, etc.).¹
- Certain contributions—including those from foundations, corporations and individuals—count as public support but are subject to a cap of 2% of total support.
- 100% of contributions from the government and nonprofits qualifying as Section 509(a)(1) charities (to the extent they also meet this public support test) count as public support.
- Membership dues count as public support so long as they do not involve substantial benefits, although they are subject to the 2% cap.
- The definition of total support (but not public support) includes gross investment income. Although an initial contribution to the endowment will count as public support (possibly subject to the 2% cap), the earnings associated with that endowment count as total support but not public support.
- ISOC can provide funding, and 100% of its contributions will count as public support. This means that the new organization will satisfy the public support test if ISOC provides a sufficient percentage (e.g., 45%) of the organization's total support. ISOC is free to set the terms of its funding through a grant agreement or a contractual commitment, and such terms could include a funding commitment over a defined period of time.

D. Administrative Complexities

- Must file applications for federal and state tax exemption.
- Should conduct an audit and prepare financial statements separately from ISOC.
- Must file a Form 990 and Form 990-T, if applicable.
- Must comply with federal and state registration and filing obligations, including charitable solicitations registrations.
- Can enter into a facilities and services arrangement with ISOC.

II. Option 2: New 501(c)(3) that Qualifies as a Type 1 Supporting Organization

A. Basic Structure

- Form a new 501(c)(3) organization that qualifies as a Type 1 supporting organization with

¹ Treas. Reg. § 1.170A-9(f)(1).

ISOC as its named supported organization; may also support a class of other organizations that share ISOC's mission.

- Mission must involve supporting ISOC's purposes and activities, and its activities must support or benefit ISOC; no grants to organizations other than ISOC and other charities that share ISOC's mission. Grants are generally payments to an organization to be used in furtherance of the grantee's purposes. Grants are distinguished from contracts for services, and the new organization could make payments to contractors other than substantial contributors and their family members and 35% controlled entities.
- Can have members that are not ISOC members.

B. Governance; Independence from ISOC

- ISOC must serve as the sole member of the corporation with the right to appoint at least a majority of the directors.² ISOC may rely on IETF to recommend directors. Although ISOC must have control, the involvement of IETF could be formalized in the governing documents. For example, the bylaws could require that ISOC consider (as opposed to follow) recommendations made by a nominating committee of IETF representatives.
- Governing documents must include special terms making it clear that the corporation is organized to support ISOC.
- Cannot be controlled directly or indirectly by any substantial contributors (other than foundation managers or 509(a)(1) or 509(a)(2) charities, such as ISOC).³
- Can perform all of the actions that are typical of a board, including hiring, evaluating, and firing the executive director and approving the annual budget.
- ISOC generally will not be liable for the corporation's debts and obligations.

C. Finances and Fundraising

- Can have a separate bank account.
- Can receive contributions directly, which may impact ISOC's public support calculation.
- ISOC can provide funding to the corporation, and ISOC can set the terms of its funding through a grant agreement or other contractual commitment which could include a funding commitment over a period of time.
- Public Interest Registry, a supporting organization of ISOC, can make grants to the new corporation as it shares a mission related to supporting ISOC.
- Not subject to a public support test so long as it is a Type 1 supporting organization.

² Treas. Reg. § 1.509(a)-4(g).

³ I.R.C. § 509(a)(3)(C).

- Cannot accept gifts from persons (other than 509(a)(1) or 509(a)(2) charities) who directly or indirectly control ISOC's board either alone or with their family members and 35% controlled entities.⁴

D. Administrative Complexities

- Must file applications for federal and state tax exemption.
- Should conduct an audit and prepare financial statements, although they will be consolidated with those of ISOC.
- Must file a separate Form 990 and Form 990-T, as applicable.
- Must comply with federal and state registration and filing obligations, including charitable solicitation registrations.
- Can enter into a facilities and services arrangement with ISOC.

III. Option 3: LLC that is a Disregarded Entity of ISOC

A. Basic Structure

- Form an LLC that is a disregarded entity of ISOC (i.e., it is treated as a branch or division of ISOC for most federal tax purposes).⁵
- Its mission should advance ISOC's overall tax-exempt purposes, but the mission does not need to focus specifically on ISOC's purposes.
- Offers flexibility in terms of the organization's activities, including grant-making, so long as they advance ISOC's overall charitable purposes.
- Can have members that are not ISOC members, although for tax purposes their dues will be revenue to ISOC and ISOC will need to substantiate their contributions.

B. Governance; Independence from ISOC

- ISOC must serve as the sole member of the LLC, with the right to appoint the board; directors can be persons recommended by IETF. Although ISOC would need to control the process, the operating agreement could require that ISOC consider recommendations made by a nominating committee consisting of IETF representatives.
- Governing documents do not need special terms regarding support of ISOC's purposes.
- Can perform all of the actions that are typical of a board, including hiring, evaluating, and firing the executive director and approving the annual budget (although ISOC may want to review expenditures for consistency with its tax-exempt status).

⁴ I.R.C. § 509(f)(2).

⁵ Treas. Reg. § 301.7701-2(a). It is not treated as a disregarded entity for employment tax and certain excise tax purposes. Treas. Reg. §§ 301.7701-2(c)(2)(iv) and (v).

- ISOC generally will not be liable for the debts or obligations of the LLC.

C. Finances and Fundraising

- Can have a separate bank account.
- Can receive contributions directly, although ISOC must substantiate donations of \$250 or more. This requires ISOC to provide a contemporaneous written acknowledgment letter to donors with specific information about the donation. The new organization should share its donation records with ISOC for this purpose.

D. Administrative Complexities

- Does not require filing an application for federal tax exemption.
- Does not require filing a separate Form 990 or Form 990-T, as applicable.
- Audit and financial statements will be handled as part of ISOC.
- May require filing an application for state tax exemption, depending on the state.
- Must comply with additional federal and state registration and filing obligations, as required.
- Can enter into a facilities and services arrangement or other similar type of arrangement to formalize resource sharing between the organizations.

IV. Option 4: Continue As Activity of ISOC

A. Basic Structure

- Maintain status quo and treat IETF administrative support activities as ISOC activities without creating a new entity.
- All activities will need to comply with ISOC's charter, mission, and corporate policies, although ISOC could work with IETF to develop a unique program strategy.
- ISOC would be liable for the actions of IETF's administrative support function.

B. Governance; Independence from ISOC

- Employees engaged in IETF administrative support activities will be ISOC employees and accountable to ISOC, including its board.
- ISOC, and not the IETF administrative support function, will be responsible for hiring and firing employees.
- Can develop an advisory committee composed of IETF representatives that reviews the IETF administrative support activities and makes recommendations to ISOC. ISOC could share certain confidential information with this committee, subject to a confidentiality arrangement. There are no requirements around who can serve on this committee.

C. Finances and Fundraising

- Can establish a separate bank account for IETF funding, but it will be an ISOC bank account that ISOC controls.
- Cannot have an EIN separate from ISOC's EIN.
- Cannot write checks or issue invoices in a name other than ISOC.
- All contributions will be made to ISOC, but donors can request that their contributions be used for IETF activities. All contributions will factor into ISOC's public support calculation.

D. Administrative Complexities

- Will not file a separate Form 990; instead ISOC's Form 990 will need to reflect all revenue and activities of IETF's administrative support activities.
- Will not file an application for federal tax exemption or any additional federal or state filings.
- Audit and financial statements will be handled by ISOC.

* * *

Sandy and David, we've outlined the options for retaining IETF's administrative support activities or transferring them to a new organization. We've presented these options at a high level, and we're happy to discuss each option in greater detail. We also note that each option provides an opportunity to change course if it becomes clear that the structure is no longer effective. Finally, this memorandum does not focus on the IETF Trust, but we are happy to discuss next steps for the IETF Trust following a decision about which option ISOC and IETF would like to pursue.