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MEMORANDUM

To: Theodore T. Mason, President, Alumni Association,
Maritime College, State University of New York

From: Laurie R. Rockett

Date: November 13, 2003

Re: Legal Implications of Incorporation of Alumni Association, Maritime College, State
University of New York as a (509)(a)(3) Organization

INCORPORATION AS A (509)(a)(3) ORGANIZATION

You have requested my opinion as to the legal implications for the Association of incorporating and becoming an organization described in (509)(a)(3) of the Internal Revenue Code as contemplated under The State University of New York ("SUNY") Guidelines for Campus-Related Alumni Associations (the "SUNY Guidelines") and the terms of the proposed contract between The State University and the Association (the "Contract").

At present the Association operates as an unincorporated charitable organization with tax exempt status under § 501(c)(3) of the Code. As such it is not only exempt from taxation, but contributions to it are deductible from its donors' personal income as charitable contributions. Its activities must be exclusively charitable in nature to maintain this status. Otherwise, its activities and operations are governed by its Constitution and Bylaws which may be amended by, respectively, a three-quarters and two-thirds affirmative vote of the membership.

Incorporation in accordance with the terms of the SUNY Guidelines and the Contract would have three significant legal effects:

1. The Association would have to be operated for the exclusive benefit of SUNY and be under its control.
2. The Association's governing documents would be subject to the provisions of the New York Not-for-Profit Corporation law.

3. Corporate status would provide additional protection to members of the Association for any personal liability arising out of the Association's activities (see final section of this memorandum).

Control by The State University

The Internal Revenue Code defines an organization described in § 509(a)(3) (defined under IRS Regulations as a "supporting organization") as one which—

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations [SUNY], and

(B) is operated, supervised, or controlled by or in connection with [SUNY].

Under IRS regulations issued pursuant to this section the Association may not have any purposes or engage in any activities which are not for the benefit of or to perform the functions of SUNY. To come into compliance with these regulations would require an amendment to the Association's Constitution and Bylaws which now provide that its purpose is

to work actively and effectively to advance the professional interests of the Maritime College of the State University of New York..., its alumni, faculty and students,.

The reference to "alumni, faculty and students" would have to be deleted or modified. In short, the Association could not take any action which was inconsistent with the interests of SUNY, even if it believed such action to be in the interests of the College's alumni, faculty or students. It would be required to engage solely in activities "which support or benefit [SUNY]".

To meet the requirements of paragraph (B) of § 509(a)(3), the regulations require that the Association be either:

- (i) Operated, supervised, or controlled by,
- (ii) Supervised or controlled in connection with, or
- (iii) Operated in connection with [SUNY].

(i) Operated, supervised, or controlled by SUNY

To meet the requirements of paragraph (i) SUNY must have

a substantial degree of direction over the policies, programs, and activities of [the Association]...The relationship required...is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization. This relationship is established by the fact that a majority of the officers, directors or trustees of the [Association] are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity, or the membership of [SUNY].

There is an exception to this requirement if the Association can demonstrate that its purposes are carried out solely by benefiting SUNY.

(ii) Supervised or controlled in connection with SUNY

To meet the requirement of paragraph (ii) there must be

common supervision or control by the persons supervising or controlling both the [Association] and [SUNY] to insure that the [Association] will be responsive to the needs and requirements of [SUNY]...the control or management of the [Association] must be vested in the same persons that control or manage [SUNY].

(iii) Operated in connection with SUNY

The Association could, alternatively, be treated as a 509(a)(3) organization within the definition of paragraph (iii) as "operated in connection with [SUNY]". Under this paragraph one or more of its officers, directors or trustees must be elected or appointed by SUNY, one or more members of SUNY's board must be an officer, director or trustee of the Association, and the officers, directors or trustees of the Association must maintain "a close and continuous working relationship with the officers directors or trustees of [SUNY]." In addition, by reason of the above relationships SUNY's officers, directors or trustees must have a significant voice in the investment policies of the Association, the timing of grants, the manner of making them, and the selection of recipients, and otherwise directing the use of its income and assets.

Finally, SUNY must be dependent upon the Association for the type of support which it provides. Such dependence will be found if the Association's activities are activities which SUNY would otherwise conduct itself or the Association makes payments of substantially all of its income to or for the use of SUNY. In addition, the amount received by SUNY must be sufficient in terms of the overall support of the relevant department of SUNY to make SUNY "attentive" to the Association.

One of the examples of a paragraph (iii) organization contained in the Regulations is that of an alumni association. In that example the university meets with a special committee of the alumni association's governing board and makes recommendations as to the allocation of the association's program of gifts and scholarships, and the association provides functions such as maintaining alumni records and publishing an alumni bulletin.

In summary, 509(a)(3) status means that the Association must be controlled by SUNY and operated exclusively to further SUNY'S interests. The degree of control is less direct under paragraph (iii), but the requirement of operation for the exclusive benefit of SUNY would still apply.

Application of the New York Not-for-Profit Corporation Law

As an unincorporated organization, the Association is not subject to the provisions of the New York Not-for-Profit Corporation Law. Its structure and operations are basically a matter of contract between its individual members as reflected in its Constitution and Bylaws. This provides greater flexibility. For example, under § 608 of that law, a quorum at a meeting of members must be at least 100 members or one-

tenth of the total number of members, whichever is less, while the Association's Constitution and Bylaws provides for a quorum of 20. Many other provisions of the Association's Constitution and Bylaws would have to be amended to comply with specific provisions of the New York Not-for-Profit Corporation Law.

In addition, unincorporated associations are subject to less regulation by the state. The courts are reluctant to intervene unless there has been a breach of the organization's governing contract, that is a failure to follow its constitution and bylaws, or some serious violation of public policy. Not-for-profit corporations, on the other hand, are subject to regulation by either the attorney general or, in the case of organizations chartered by the Board of Regents, by the State Department of Education.

Personal Liability arising out of the Association's Activities

The primary purpose of incorporating an organization under New York law is to shield its members from personal liability for the organization's debts, other obligations or torts. Generally speaking, all members of an association are jointly and severally liable for the obligations of an unincorporated association, if the action giving rise to the liability was authorized in accordance with the association's governing documents although there is authority to the effect that such liability is limited to the amount of the assets of the organization.