Creating Nonprofit Chapters and Affiliates

Successful nonprofits looking for ways to make their programs more widely available often look to grow by creating chapters and affiliates in other geographic areas. Nonprofit organizations that are organized geographically into chapters that share a name, trademarks and mission are frequently referred to as "federated organizations."

These entities take an amazing variety of legal forms with some being tightly controlled and hierarchical and others being more loosely affiliated and autonomous. Historically, many federated organizations have grown on an ad hoc basis with little thought to how the chapters are linked or what their legal relationship to the founding organization will be. Often, the founding organization finds itself in the position of policing valuable trademarks and servicemarks to uphold the organization's reputation and goodwill, essential commodities for any organization that is funded by donations from the public.

Over the years, a number of well-known organizations that quickly spawned numerous chapters have been forced to impose order on their chapters and affiliates long after their creation. Published reports have documented the struggles that some of these federated nonprofit organizations have experienced. Ideally, to avoid these struggles, nonprofits considering spinning off chapters or affiliates should give careful thought to how they will structure their federated organization before creating their first chapter or affiliate.

There are three affiliate models that are most commonly encountered among federated nonprofit organizations. They include the following models:

- a single corporation operating in multiple jurisdictions;
- separate subsidiary corporations in multiple jurisdictions; or
- separate corporations in multiple jurisdictions that operate pursuant to affiliation agreements.

Single Corporation. The primary advantage of the single corporation model is that the founding organization (or "Parent") retains maximum control over its activities. However, the Parent's Board will bear any liability for its out of state activities. Thus, a successful claim against any one state's program will expose all of the Parent's assets and the out of state programs to liability.

Separate Subsidiary Corporations. Another alternative is to create separate subsidiary corporations ("Subsidiary') in each state where the Parent operates an out of state program. The Parent can retain ultimate control over the out of state programs by retaining the right to appoint the board of directors or by acting as the sole voting member of a membership corporation. This structure permits the Subsidiaries some protection from the potential liabilities associated with the other Subsidiaries.

Separate Affiliated Corporations. The third approach is to create a truly separate corporation in each state where the Parent operates. Each corporation, or Chapter, would have a separate, locally elected board of directors that would be legally responsible for the activities of the corporation that it governs. The Parent's authority over the out of state corporations would be as set forth in a Charter and License agreement between each Chapter and the Parent. Such an agreement would, among other things, outline the terms governing the Chapters' use of the Parent's name and logo, define the geographic scope of each Chapter's activities, etc. The greatest advantage of this approach is that it shifts maximum responsibility (and the corresponding liability) for local operations to the local Chapters.

Another twist on this approach that increases the Parent's influence over the Chapters is to apply for a group exemption and to list each Chapter as a subordinate under the Parent's group exemption. The benefit of this model is that it permits the chapters to gain tax-exempt status without going through the expensive and often time consuming application process; however, to qualify as a subordinate under the Parent's group tax exemption, the Chapters have to submit to some degree of control and supervision by the Parent. Under the group exemption model, the Chapters would be able to file their own Form 990s relieving the Parent of responsibility for tax reporting and compliance on behalf of each Chapter.

Regardless of which organizational structure a nonprofit organization chooses, a thoughtful growth plan will help to ensure the long-term success of the organization and avoid struggles among the chapters and the parent for years to come.