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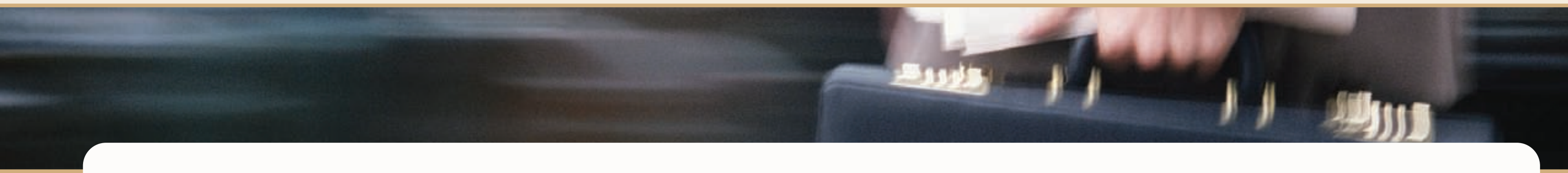
BUSINESS NOTES
MARCH 2007



PROCEED WITH CAUTION

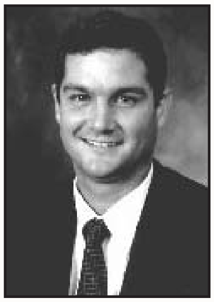
It is not uncommon for 501(c)(3) non-profit organizations, large and small, to have money making opportunities during their existence. For instance, a larger non-profit organization may have a talented IT department that creates software to benefit the organization, but which can later be marketed to other organizations. In addition, a non-profit organization may receive a bequest of income producing property. Since 501(c)(3) non-profit organizations must be created and operated exclusively for charitable purposes, and not to generate profits, should these organizations ignore these opportunities and miss out on the income that could benefit their just causes, or can they take action? The short answer is that action can be taken but with caution.

There are several risks for non-profit organizations engaging in money making operations. First and foremost, non-profit organizations do not want to lose their 501(c)(3) status since the Internal Revenue Code provides that an organization is only exempt from federal income taxation if it is organized and operated exclusively for charitable and educational purposes. It is important to note that the organization must be organized and operated for the charitable purpose and therefore, if one of these is not met, the organization is not tax exempt.

The Internal Revenue Code does provide that an organization may still meet this test if the operation of the trade or business is in furtherance of the organization's exempt purpose and if the organization is not organized for the primary purpose of carrying on an unrelated trade or business. However, the Internal Revenue Code also imposes a tax on the "unrelated business taxable income" of organizations otherwise exempt from federal tax under Section 501. Since "unrelated business taxable income" does not include dividends, the most common approach is for non-profit organizations to form for a profit subsidiary to pursue the business opportunity that is unrelated to the organizations charitable or educational purpose.

Of course, this does not mean that the income producing opportunity is not taxable. Since dividends are made out of the after tax earnings of for-profit companies, the Internal Revenue Service allows distributions (or dividends) to be made to 501(c)(3) organizations while preserving their exempt status. That is, the for-profit entity pays taxes just like any other for-profit organization, and then the for-profit entity makes distributions to its parent, the non-profit organization. Another benefit to this approach is that the non-profit parent organizations can benefit from certain protections afforded by the limited liability laws of the various states by organizing separate legal entities to engage in the opportunity.

While forming a for-profit subsidiary is the most common approach, it is important to note that simply forming a subsidiary to run a for-profit operation will not by itself protect the tax-exempt status of a non-profit organization. The Federal Regulations provide that whether a non-profit organization can maintain its tax-exempt status will be decided on a case-by-case basis.



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COMMERCIAL LEASES: EXCLUSIVE AND PROHIBITED USE CLAUSES

Most commercial leases for multi tenant properties contain clauses which regulate the tenants' use of the leased premises. Many tenants will require a landlord grant the tenant the exclusive right to operate a certain business or sell a certain product to avoid competing with other tenants. These provisions are appropriately referred to as exclusive use clauses. For the landlord to satisfy its obligations under an exclusive use clause of one lease, the landlord is required to incorporate provisions in its other leases prohibiting the other tenants from using the leased premises for the restricted purpose. These clauses are commonly referred to as prohibited use clauses.

A landlord may also include a prohibited use clause to prevent a tenant from using the leased premises in a manner which the landlord believes is a nuisance to the other tenants and reducing the overall value of the property. For example, a landlord may consider a bowling alley or a night club as a nuisance.

A tenant being able to negotiate an exclusive use provision in the lease can have a significant impact on the financial success of the business. However, landlords will be hesitant to grant an exclusive use if it will limit the landlord's ability to rent the other locations on the property. If a landlord does grant an exclusive use, the landlord must be prepared to incorporate corresponding prohibited use clauses in the leases of all of the other tenants.

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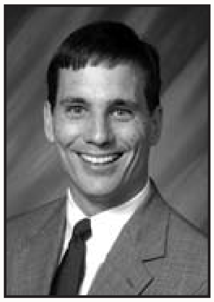

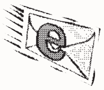

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