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How to Create and Operate a Related Foundation – Legal Considerations

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Why Associations Form Related Foundations

- Most (2/3 of) associations are formed as 501(c)(6) tax-exempt organizations; some (1/3) of associations are formed as 501(c)(3) entities
- 501(c)(6) associations can form related, affiliated, controlled 501(c)(3) tax-exempt organizations

Why Associations Form Related Foundations (*cont.*)

- 501(c)(3) key benefits:
 - Receive tax-deductible charitable contributions (cash, property, etc.)
 - Qualify for some federal, state, and local government grants and charitable grants
 - Receive private foundation grants without the private foundation having to exercise “expenditure responsibility”
 - Qualify for some state and local tax exemptions: sales and use; real property
 - Participate in tax-exempt bond financing
 - Receive charitable bequests (*e.g.*, tax-beneficial giving as part of a will, charitable gift annuities, charitable remainder trusts)

Flow of Funds and Other Value Between Association and Foundation

- The (c)(6) association *can* subsidize and transfer funds and other things of value (such as staff time) to the (c)(3) foundation without restriction
- The (c)(3) foundation *cannot* do the same; anything of value that flows from the (c)(3) foundation to the (c)(6) association must either be in furtherance of its (c)(3) purposes or be in exchange for fair market value consideration

Flow of Funds and Other Value Between Association and Foundation (*cont.*)

- The relationship between the (c)(6) association and the (c)(3) foundation should be codified contractually in a written affiliation agreement that governs the relationship between them, spells out the governance control by the association over the foundation, details the provision of staff and administrative services from the association to the foundation, and provides for a trademark license of the association's name (and logo) to the foundation; sometimes a license of certain copyrights will also be included
- Discounts to Members: Association must provide something of comparable value to foundation in return for foundation providing discounts to association members on foundation's products or services; cannot limit participation/attendance to association members only due to the fact that (c)(3) status requires "public" benefit, not just to the association's industry or profession

Legal and Tax Structure

- Separate corporate existence
 - Important for both federal tax exemption and corporate separateness (liability) purposes
 - Maintain separate boards but there can be overlap between them and with officers; usually, the association's board will appoint (and have the ability to remove) the directors and officers of the foundation
 - Follow all corporate formalities (*e.g.*, contracts entered into in the name of each entity, separate board meetings, separate meeting minutes)
 - Keep finances separate (*e.g.*, separate bank accounts, separate IRS Forms 990, consolidated audited financial statements usually required)
 - Be mindful of and carefully manage conflicts of interest
 - Use each entity's name appropriately in all instances
 - Define clear, complementary missions for each entity

Legal and Tax Structure (*cont.*)

- Avoid private foundation status – the foundation will generally want to qualify as a public charity as a “supporting organization” under IRC Section 509(a)(3); this also provides a legal “excuse” for more control by the association over the foundation
- If the foundation is established as a supporting organization, then the IRS looks to the association to determine if it (as the supported organization) meets either the 509(a)(1) or 509(a)(2) public support test; virtually all associations will satisfy the 509(a)(2) public support test

Questions?

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