Separate Entity to Hold Riskier Properties

Some real property is substantially riskier than other property for an organization to hold and manage, perhaps because of environmental contamination (or suspicion of the same), perhaps because of more intense public use, perhaps for some other reason. Depending on just how great the perceived risk, the organization may want to consider isolating its exposure to that risk by establishing a separate organization—wholly controlled by the founding organization—to hold the riskier property.

Single-Member Nonprofit Organization

Exposure to financial risk associated with land ownership will vary with circumstances, but if any number of unfortunate scenarios were to occur, the endowment and other funds that a charitable organization needs to continue its programs and operations could be threatened by payments required by court order.

For example, if a government agency or court were to find an organization responsible for past environmental contamination of their land (even if the organization had nothing to do with the contamination), the resulting financial liability could be catastrophic to the organization. Likewise, if a claim for serious injury or death on an organization's property is for some reason not barred by immunity, the organization's insurance may not be sufficient to satisfy the verdict or settlement reached.

One safeguard to explore draws from a common for-profit sector practice: A nonprofit charitable organization (the "founding organization") could create a single-member nonprofit organization, wholly controlled by the founding organization. The founding organization could then assign all public access easements to the single-member nonprofit organization, which would hold no other assets (which might be vulnerable in a lawsuit). The single-member nonprofit organization would be a named insured or named as additional insured on the policies of public liability insurance carried by the founding organization so as to provide insurance coverage and defense of claims arising from the public access. The single-member nonprofit organization would *not* be recognized as a separate entity for federal tax purposes (meaning no extra tax filings), while limiting the founding organization's liability under state law.

There is always the possibility of a court collapsing the two entities into one (a process known as "piercing the corporate veil"). However, separating higher risk activities from lower risk ones is a perfectly legitimate business strategy, and there's no reason why nonprofits shouldn't use the strategy if it is determined that the benefits outweigh the trouble in establishing and maintaining the arrangement.

Benefits Worth the Trouble?

Experience of conservation organizations

The separate entity strategy has been adopted occasionally by conservation organizations. In Pennsylvania, for example:

- Wissahickon Trails in 2006 established a wholly owned subsidiary—called the Wissahickon Waterfowl Preserve—to take ownership of a problematic parcel in Ambler because of its importance to birds and the community. In 2009, the EPA placed the site, which had been used up through the 1960s for asbestos waste disposal, on the National Priorities List of hazardous waste sites, making it eligible for federal Superfund cleanup funding. In subsequent years, the asbestos was capped per EPA remediation plans. The EPA determined that the Wissahickon Waterfowl Preserve was not responsible for the contamination and thus was not charged for any of the mitigation work. (However, the organization is responsible for ensuring that the property is cared for in such a way as to minimize damage to the mitigation infrastructure and for regulatory reporting to environmental regulators on the conditions of the site.) Wissahickon Trails' involvement enabled a blighted area to become a beautiful asset and a beloved birding spot for the community. Recently, the question was raised whether it made sense to continue the trouble of maintaining separate corporations, given the EPA's determination of non-responsibility, and Wissahickon Trails was advised by legal counsel to continue to maintain the subsidiary due to the unknowns of the future.

- Berks Nature maintained a separate holding entity for many years to isolate liability. However, when applying for land trust accreditation, Berks' leaders judged that continuing to maintain the separate entity for the difficult-to-quantify benefit of isolating liability was not worth the added complication and expense of having to accredit two separate organizations. Following from this, Berks Nature dissolved the holding entity in 2022.
- At least one land trust maintains one or more separate 509(a)3 organizations to which it can assign properties—for liability purposes or otherwise—as it deems advantageous.

These examples aside, the risk profile of any organization's existing and potential property holdings is unique, and thus it is necessary to make an individualized assessment of the potential utility of this tool for each organization and situation.

Does the strategy make sense for a particular scenario?

Is the separate entity strategy worth pursuing for any particular scenario? Clearly it is in any number of for-profit sector scenarios. And obviously, the higher the risk presented, the greater the chance that it will make for a sensible strategy, no matter whether it is a for-profit, charitable sector, or specific conservation or outdoor recreation nonprofit venture.

Beyond that general observation, the authors lack a sufficient number of examples from which to base more pointed guidance as to whether the liability protection achieved is worth the trouble in achieving it. The lack of readily apparent examples should not serve as an indicator of the utility of the strategy. For one, the authors confined their inquiries to land trusts operating in Pennsylvania. Other factors might include: (1) the strategy is largely unknown to organizations; (2) it is sufficiently complex to steer people away for lack of local expertise; and (3) when considered, the added complexity and the need to travel a learning curve may be judged not worth the potential benefit provided.

The issues surrounding the development and implementation of an effective strategy for isolating risk are complex. If an organization wants to further investigate or pursue the strategy, it should hire competent legal assistance to help it navigate the complexities in the context of the organization's particular circumstances.

Implementation

Single purpose entity

The first step to implement the strategy is for the primary organization (the "parent") to create an entity (the term used in commercial transactions is a single purpose entity or SPE) to own the assets involved in higher risk activities. In this case, the parent would transfer to the SPE some or all of its real estate holdings. The SPE is named as an insured on the policies of liability insurance carried by the parent so as to provide coverage for claims against the parent, the SPE and any indemnified parties. The SPE can be set up as a single-member non-profit organization, thus vesting in parent, as sole member, total control over the SPE.

Separate entity for liability purposes

So long as the formalities of separate existence are observed (for example, separate annual meetings, election of officers, bank accounts) the parent, and its assets, will be shielded from claims against the SPE. But if the directors and officers of the parent treat the two entities as if they were one, a court can "pierce the corporate veil" and allow recovery against the parent.

Single entity for tax purposes?

The SPE can take any form available under state law that provides protection for the parent. A non-profit corporation controlled by the parent as single member is an obvious choice for these purposes but there is a federal tax reason to consider forming the SPE as a single member limited liability company. Single member LLCs, unlike single member corporations, are "disregarded" for federal tax purposes; in other words, they are *not* recognized as an entity separate from the parent. The result is that contributions of land or easements to the SPE (if it has been formed as a single member limited liability company) are treated, for federal tax purposes, as if the donations had been made to the parent. The parent's status for purposes of determining tax deductibility under the Code (for example, recognition as a public charity under §501(c)(3)) automatically extends to the limited liability company it controls.

Impact on land trust accreditation?

Potential applicants for land trust accreditation are encouraged to contact the Land Trust Accreditation Commission to discuss the specifics of their parent and SPE relationship. The commission determines how to proceed with accreditation on a case-by-case basis.

Property taxes

For those organizations desiring a property tax exemption for a particular parcel, placing that land in a separate entity could complicate the possibility of securing the exemption from a county board of property assessment.

Other Strategies for Reducing Risk

The guide *Reducing Liability Associated with Public Access* looks at various ways that an organization can reduce risk of injury and loss of life and property claims.

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A portion of this guide appeared in different form in the guide *Reducing Liability Associated with Public Access* authored by Pregmon and Loza.

WeConservePA offers this guide thanks to support from the Colcom Foundation, the William Penn Foundation, and the Community Conservation Partnerships Program, Environmental Stewardship Fund, under the administration of the Pennsylvania Department of Conservation and Natural Resources, Bureau of Recreation and Conservation.

v. 2023.06.24