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March 31, 2008

**BY ELECTRONIC MAIL**

The Board of Officers, Executive Committee and Members of  
APCO International, Inc.  
351 North Williamson Avenue  
Daytona Beach, FL 32114

**Re: APCO Conversion and Combined Group Reorganization**

Ladies and Gentlemen:

We have been asked to provide guidance as special tax and corporate counsel to APCO International, Inc. with respect to (1) a proposed conversion of APCO International, Inc. from a Section 501(c)(6) organization to a Section 501(c)(3) organization; and (2) a proposed merger of one or more of the remaining organizations of the APCO Combined Group, namely, the APCO Institute, APCO Automated Frequency Coordination and the Heritage Foundation, into APCO International. For the purposes of our initial review, APCO provided us with copies of APCO International's Articles of Incorporation and financial statements for the APCO Combined Group for the six months ending December 31, 2007. Although we recommend a more detailed review to confirm our initial findings, we believe that APCO International could satisfy the requirements of a Section 501(c)(3) organization. Assuming APCO is recognized by the Internal Revenue Service as tax-exempt under Section 501(c)(3), one or more of the remaining organizations of the APCO Combined Group could then be merged into APCO, thus streamlining the APCO Combined Group and reducing administrative and other costs.

The remainder of our letter briefly summarizes the requirements for Section 501(c)(3) status, the advantages and disadvantages of such status and the reorganization of the APCO Combined Group and outlines a possible future course of action to effect the conversion and the reorganization.

**I. Section 501(c)(3) Requirements.**

To be recognized as a Section 501(c)(3) organization and to maintain such status, APCO must meet certain requirements:

1. Organizational Test. To be recognized as a Section 501(c)(3) organization, APCO must include certain provisions in its Articles of Incorporation filed with the Florida Secretary of State. These provisions state that APCO is organized and operated exclusively for charitable and educational purposes, that “no part of the net earnings of APCO inures to the benefit of any private shareholder or individual,” that APCO will not engage in any political activities, that it will lobby only to an insubstantial extent and that, upon dissolution, APCO’s assets will be distributed to another Section 501(c)(3) organization. These statements are explained in greater detail, below. If APCO’s Articles of Incorporation do not contain these provisions, APCO will not be recognized as a Section 501(c)(3) organization. A draft of Articles of Amendment incorporating the required language is enclosed with this letter for your consideration.

2. Operational Test. To be recognized as a Section 501(c)(3) organization, APCO must be operated primarily for charitable, educational and scientific purposes. As long as APCO primarily engages in activities in furtherance of such charitable, educational and scientific purposes, it will satisfy the operational test. We have been advised that the primary purposes of APCO are to (i) foster the development and progress of public safety communications and supporting information technologies by means of research, planning, coordination, training and education in areas concerned with law enforcement, fire, emergency rescue and medical services, conservation, forestry, highway maintenance, emergency management and other public safety services; (ii) promote the rapid and accurate collection, exchange and dissemination of information relating to emergencies and other vital public safety communications among and between all levels of local, state and federal governments and those who work with them; and (iii) strive to protect the citizen and their property and provide for their welfare by these and other appropriate means. These purposes appear to us to be charitable, educational and scientific. Assuming APCO’s actual activities are intended to, and do further and support these purposes, then APCO should be able to meet this operational test. We believe that it would be prudent, however, for us to review APCO’s web site, program documents and other operational materials to make sure that this operational test is satisfied.

3. Inurement Prohibition. A Section 501(c)(3) organization is formed and operated for public purposes. Its assets belong to the public and are dedicated to the fulfillment of the charitable purposes for which it is formed. The assets of a Section 501(c)(3) organization do not belong to any individual or any group of individuals. If the Section 501(c)(3) organization ceases operations, its assets must be distributed to another charitable organization.

Charitable assets must not serve private purposes, particularly the private purpose of the Section 501(c)(3) organization’s insiders (i.e., its directors and officers). This principle, also known as inurement, focuses on an insider’s ability to divert charitable assets away from their intended, charitable purposes and instead to the limited, private uses of the insider. The classic example is that of a founder of an organization who diverts the organization’s funds to the organizer’s own personal uses or those of the organizer’s family. This is not to imply, however, that a Section 501(c)(3) organization is precluded from paying for services rendered by insiders

to the organization or for goods provided to the organization by such individuals. On the contrary, a Section 501(c)(3) organization may provide reasonable compensation to an insider for services rendered or goods received. If compensation is unreasonable or excessive, however, the excess constitutes inurement. The presence of any inurement could result in a denial or revocation of Section 501(c)(3) status. Thus, transactions between a Section 501(c)(3) organization and its directors and officers must be carefully scrutinized.

We understand that there are currently no contracts or monetary arrangements between APCO and any of its directors or officers. Thus, we do not view the inurement prohibition as an obstacle to APCO's conversion to Section 501(c)(3) status.

4. Restriction on Lobbying Activities. Section 501(c)(3) organizations are restricted in the amount of lobbying that they may undertake. "Lobbying" is defined as the attempt to influence the passage or defeat of legislation. Section 501(c)(3) organizations may lobby only to an "insubstantial" extent. If a Section 501(c)(3) engages in substantial lobbying, it will forfeit its charitable status.

A Section 501(c)(3) organization may make an election under section 501(h) of the Internal Revenue Code that will provide it with a formula to determine how much lobbying it may undertake before it risks forfeiture of its Section 501(c)(3) status. A Section 501(c)(3) organization that makes this election may expend up to the lesser of \$1,000,000 or:

- a. 20% of its exempt purpose expenditures up to \$500,000, plus
- b. 15% of the excess of its exempt purpose expenditures over \$500,000 but not over \$1,000,000, plus
- c. 10% of the excess of its exempt purpose expenditures over \$1,000,000 but not over \$1,500,000, plus
- d. 5% of the excess of its exempt purpose expenditures over \$1,500,000.

"Exempt purpose expenditures" means the total of the amounts paid or incurred (including depreciation and amortization, but not capital expenditures) by an organization for the tax year to accomplish its exempt purposes. In addition, it includes: administrative expenses paid or incurred for the organization's exempt purposes, and, amounts paid or incurred for the purpose of influencing legislation, whether or not the legislation promotes the organization's exempt purposes. Exempt purpose expenditures generally do not include fundraising expenses.

We understand that APCO typically spends less than \$100,000 a year in lobbying costs. Bear in mind that involvement in and responses to regulatory proceedings, which we understand to be the mainstay of the work of your regulatory counsel, are not considered lobbying under the Internal Revenue Service regulations. If APCO were to make the Section 501(h) election described above, and assuming exempt purpose expenditures of roughly \$5,000,000, APCO could spend up to \$400,000 on its lobbying activities without jeopardizing its Section 501(c)(3) status. Thus, we do not believe the lobbying restriction would be an obstacle to APCO's conversion to Section 501(c)(3) status.

5. Political Activity Prohibition. Section 501(c)(3) organizations may not engage in any political activities. Political activities are activities that support the election or defeat of a candidate for political office, whether at the federal, state or local level. Engaging in any political activity by the organization endangers its Section 501(c)(3) status. We understand that APCO currently does not engage in any political activities, nor does it maintain a political action committee. Thus, we believe that the political activity prohibition should not be viewed as an obstacle to APCO's conversion to Section 501(c)(3) status.

6. Public Support Test. There are two types of Section 501(c)(3) organizations: public charities and private foundations. Private foundations generally receive the bulk of their financial support from a limited number of individuals. They tend to be run by these individuals, as well. Because of their limited support, direction and focus, the Internal Revenue Code imposes more requirements and excise taxes on such organizations.

It is in the best interests of any Section 501(c)(3) organization to be characterized as a public charity, rather than a private foundation. To be a public charity, an organization must meet one of two support tests. The first support test focuses on donations that the organization receives from the public. Public charities, such as the Red Cross and United Way, receive donations from thousands of individuals and, thus, meet the public support test. The second support test is designed for organizations that receive most of their financial support via service fees and other sources of income earned from activities conducted in furtherance of their exempt purposes. We would expect that APCO, which receives exhibit fees, conference registration fees, membership dues, training and course fees, publication sale fees, all from the exercise of activities conducted in support of its exempt purposes, would easily satisfy this second test. We recommend that APCO's internal accountant or controller calculate the relevant support percentage just to make certain that APCO meets this test.

This second support test also places a limitation on the amount of gross investment income and unrelated business income that such Section 501(c)(3) organization may receive. No more than one-third of the organization's income may come from such sources. Based on its 2008 interim financial statements, it appears that APCO should not have any problem satisfying this test; however, we recommend that APCO's internal accountant or controller confirm this.

Based on the above, we believe that APCO should be able to meet the requirements for Section 501(c)(3) status.

## **II. Advantages and Disadvantages of Section 501(c)(3) Status.**

Section 501(c)(3) status confers a number of advantages upon the organization.

1. Ability to Attract Charitable Contributions and Grants. Section 501(c)(3) organizations have the ability to attract charitable contributions from the public, as well as grants from government agencies, corporations and private foundations. Section 501(c)(6) organizations do not have such ability.

2. Greater Exemption from State and Local Taxes. Many state and localities exempt Section 501(c)(3) organizations from a variety of taxes, such as sales and use taxes, property taxes, franchise taxes and other forms of business-related taxes. For instance, Maryland and the District of Columbia exempt Section 501(c)(3) organizations from sales and use taxes and property taxes. Section 501(c)(6) organizations are not exempt from such taxes.

3. Public Perception. Typically, Section 501(c)(3) organizations enjoy a higher level of standing in the public's eyes than industry groups, such as Section 501(c)(6) organizations. This is because Section 501(c)(3) organizations are formed for public purposes, as opposed to Section 501(c)(6) organizations, which typically serve the interests of an industry or a particular line of business. Many organizations choose to become section 501(c)(3) organizations because of this higher level of standing.

4. Disclosures and Recordkeeping. The higher visibility of Section 501(c)(3) organizations does come with a cost--namely, more disclosures and more recordkeeping. For example, both Section 501(c)(3) organizations and Section 501(c)(6) organizations must file an annual information report on Form 990 with the Internal Revenue Service. A Section 501(c)(3) organization has to file more schedules as part of the Form 990, than a Section 501(c)(6) organization does.

Form 990 for both Section 501(c)(3) organizations and Section 501(c)(6) organizations are public documents. Both types of organizations must make their Forms 990 for their three most recent tax years available to the public upon request. Neither type of organization, however, is required to disclose the names of its donors that appear on Schedule B of Form 990. Moreover, the Internal Revenue Service does not make the names of donors appearing on Schedule B of Form 990 available to the public.

5. Public Accountability and Good Governance. Section 501(c)(3) organizations enjoy greater visibility than their Section 501(c)(6) counterparts; however, because they serve the public, they are subject to greater public scrutiny. Many watchdog organizations monitor the

activities of Section 501(c)(3) organizations. Others, including the Senate Finance Committee and various state attorneys general, have called for more accountability and better governance practices from Section 501(c)(3) organizations. APCO should view its present efforts at governance reform as an important step if it chooses to convert to section 501(c)(3) status.

### **III. Combined Group Reorganization.**

1. Lower Administrative Costs. Separate organizations require separate boards, separate books and records, and separate federal and state filings. Thus, APCO should realize some cost savings by combining one or more of the organizations of the APCO Combined Group into the new APCO that is recognized under Section 501(c)(3).

If separateness of the APCO Combined Group organizations is not maintained, the organizations will be viewed as one larger, combined organization. In such case, any benefit from having separate organizations would not exist. The more that one of the organizations of the APCO Combined Group participates in the day-to-day activities and decisions of another organization of the APCO Combined Group, the greater the chances that an aggrieved third party would challenge the separateness of the organizations.

2. Separate Accounts. Even if one of the more of the organizations of the APCO Combined Group are combined into the new APCO, separate accounts could be established for the assets of these organizations and restricted for their original charitable purposes (e.g., the Heritage Foundation). These separate accounts could be either separate bank accounts or mere bookkeeping entries.

3. Improved Governance. Combining one or more of the APCO Combined Group organizations into the new APCO would enable the APCO Board of Officers to more directly control the activities of the APCO Combined Group. This control exists currently because, as we understand, the APCO Board also serves as the board of these other organizations. This scheme of identical boards increases the possibility that a third party may try to pierce the corporate veil if its claim against one or more of the organizations of the APCO Combined Group fails because of insufficient assets.

### **IV. Next Steps.**

1. Conversion to Section 501(c)(3) Status. There are a number of ways that APCO could convert to Section 501(c)(3) status. The most straightforward would consist of (i) filing Articles of Amendment with the Florida Secretary of State; and (2) completing and filing with the Internal Revenue Service an application for recognition for Section 501(c)(3) status for APCO. This application is designed to illicit information to enable the Internal Revenue Service to determine if the applicant organization satisfies the requirements for Section 501(c)(3) status.

The Board of Officers, Executive Committee and Members of  
APCO International, Inc.

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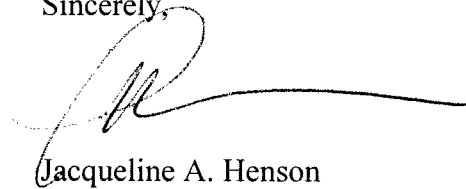
Review may take 2-6 months; there are ways, however, to expedite the review and shorten this period.

Another method of conversion may be to use one of the present Section 501(c)(3) organizations of the APCO Combined Group and change it into the new APCO. We would have to explore the feasibility of this approach by reviewing the organizational documents of these organizations. The benefit of this approach would be that it would bypass the extensive IRS review and the waiting period. There would still, however, be disclosure to the Internal Revenue Service of the new activities being undertaken by the APCO Combined Group organization.

2. Merger. If APCO chooses to combine one or more of the organizations of the APCO Combined Group into the new APCO, this could be accomplished by having the governing board of such organization direct that the APCO Combined Group organization dissolve and transfer its assets to the new APCO. This transfer of assets must occur after the Internal Revenue Service has recognized APCO as a Section 501(c)(3) organization. All that is required is the filing of Articles of Dissolution with the Florida Secretary of State and a final Form 990 with the Internal Revenue Service.

If you have any questions, or if you require additional information, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to be 'JAH', with a long horizontal flourish extending to the right.

Jacqueline A. Henson

JAH/wlb  
Enclosures