

Legal Intensive Learning Lab

ASF National Conference
Austin, TX
October 12, 2010



2

Agenda

- 9:00 Welcome & Introductions
- 9:10 Part 1: Foundations in Context
- 9:35 Part 2: Responsibilities of the Board & the Private Foundation Rules
- 10:45 BREAK
- 11:00 Part 3: Legal Issues in the Grantmaking Cycle
- 11:45 Final Questions
- 12:00 Seminar Concludes

A Very Brief History of Private Foundations in the U.S.

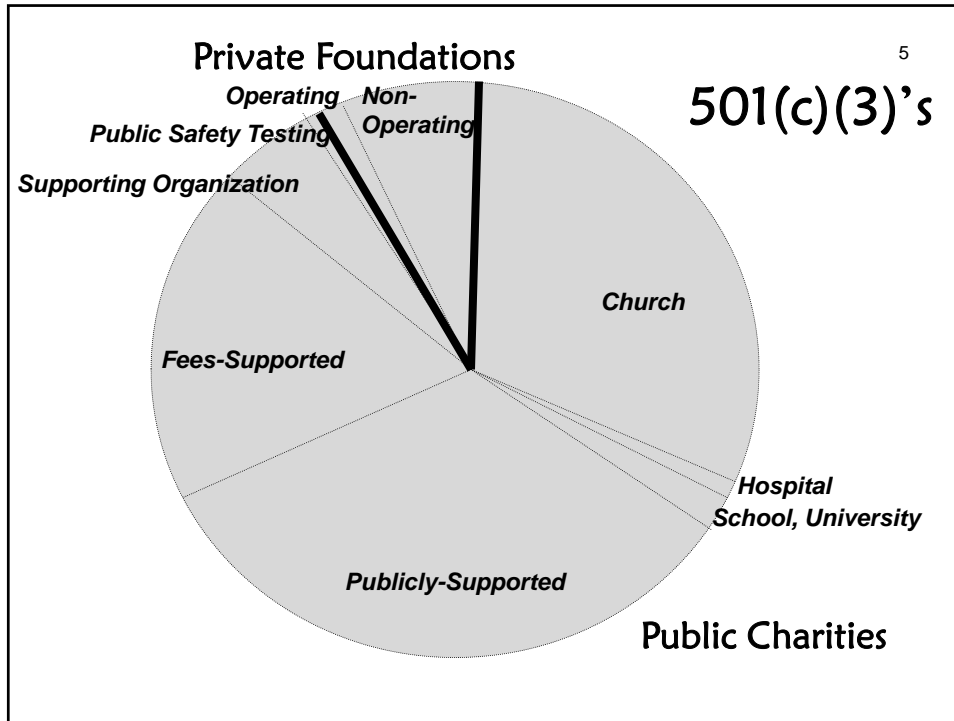
3

- Early historical context
- Federal level benefits for charitable organizations begin:
 - 1913 – created federal income tax & exempted “charities”
 - 1917 – charitable deductions for contributions
 - Differentiation between types of charities increases
- **Tax Reform Act of 1969**
- Trends since 1969

Legal Framework: Tax Exempt Organizations under 501(c)

4

- 501(c)(1) – Corporations organized under acts of Congress such as Federal Credit Unions
- 501(c)(2) – Title holding corporations for exempt organizations
- 501(c)(3) – Various charitable, non-profit, religious, and educational organizations
- 501(c)(4) – Various political education organizations
- 501(c)(5) – Labor Unions and Agriculture
- 501(c)(6) – Business league and chamber of commerce organizations
- 501(c)(7) – Recreational club organizations
- 501(c)(8) – Fraternal beneficiary societies
- 501(c)(9) – Voluntary Employee Beneficiary Associations
- 501(c)(10) – Fraternal lodge societies
- 501(c)(11) – Teachers' retirement fund associations
- 501(c)(12) – Local Benevolent Life Insurance Associations, Mutual Irrigation and Telephone Companies and like organizations
- 501(c)(13) – Cemetery companies
- 501(c)(14) – Credit unions
- 501(c)(15) – Mutual insurance companies
- 501(c)(16) – Corporations organized to finance crop operations
- 501(c)(17) – Employees' associations
- 501(c)(18) – Employee-funded pension trusts created before June 25, 1959
- 501(c)(19) – Veterans' organizations
- 501(c)(20) – Group legal services plan organizations
- 501(c)(21) – Black lung benefit trusts
- 501(c)(22) – Withdrawal liability payment fund
- 501(c)(23) – Veterans' organizations created before 1880
- 501(c)(25) – Title-holding corporations for qualified exempt organizations
- 501(c)(26) – State-sponsored high-risk health coverage organizations
- 501(c)(27) – State-sponsored workers' compensation reinsurance organizations
- 501(c)(28) – National railroad retirement investment trust



6

Differences within 501(c)(3): Private Foundations / Public Charities

- Private Foundations
 - Typically one (or very few funding sources)
 - Less favorable tax deductions for donors
 - Less public oversight = more operating restrictions

- Public Charities
 - Typically supported through diverse sources
 - Greater public input = fewer restrictions
 - Includes community foundations, public foundations and gift funds associated with commercial firms

Focus on Private Foundations

- Less favorable tax deduction limits for donors
 - No favorable deduction for real estate or non-publicly traded stock
 - Large donations are more limited against donors annual income
- Less public oversight = more operating restrictions
 - Private Foundation Rules covered in later session today

The Private Foundation Lifecycle: Times to Watch for Legal Issues

- Birth
 - Corporation or Trust
 - Bylaws
 - Tax Exemption Application
- Functioning in Society
 - Minutes & Policies
 - Direct charitable activities
 - Grant making
 - Periodic (e.g., Annual) Filings
- Managing Risks
 - Liability, Directors' & Officers', and Other Insurance
- Life Changes
 - Amended Articles
 - Amended Bylaws
 - Mergers
- Death
 - Dissolution, Termination, and/or Conversion

Public Policy: Hot Legal Issues

- IRS Thinking More About Governance
 - Policies
- Pension Protection Act 2006 & Aftermath
 - Donor Advised Fund limitations
 - Contributions to some types of Supporting Organizations no longer part of annual minimum payout, other changes.
 - Making large grants to small charities – the new public support test rules



RESPONSIBILITIES OF THE BOARD & THE PRIVATE FOUNDATION RULES

STATE LAWS

- Fiduciary Duties of Board
 - Duty of Loyalty
 - Act in best interests of foundation
 - Duty of Care
 - Awareness
 - Participation
 - Level of Care
 - Duty of Obedience
 - Follow foundation rules and carry out foundation's charitable purpose

11

STATE LAWS

- Investments:
 - Prudent Investors Act
 - Adopted by most states
 - Total return concept; diversification; delegation
 - Uniform [Prudent] Management of Institutional Funds Act
 - Adopted by some states
 - Applies to charitable corporations
- Employment –Related
- Initial and Annual Registration and Reporting

12

FEDERAL LAWS FOR PRIVATE FOUNDATIONS

- Tax Returns & Public Disclosure
- Advocacy & Lobbying
- Private Foundation Rules
 1. Paying Excise Tax
 2. Self-Dealing Rules
 3. Mandatory Distribution - 5% Payout
 4. Excess Business Holdings
 5. Jeopardizing Investments
 6. Taxable Expenditures

13

TAX RETURNS & PUBLIC DISCLOSURE

- 990-PF or 990
 - Required annually
 - Make sure your accountant knows what he or she is doing!
- The following must be made publicly available:
 - Form 990-PF or 990
 - Form 1023
 - Form 990-T
- Public document / public face
 - www.guidestar.org for private foundations

14

ADVOCACY & LOBBYING

- Foundations CAN fund advocacy
- Foundations CANNOT *earmark* grant funds for lobbying
- Foundations CANNOT fund elections

15

FEDERAL LAWS FOR PRIVATE FOUNDATIONS

- Public Disclosure & the 990-PF
- Advocacy & Lobbying
- Private Foundation Rules
 1. **Paying Excise Tax**
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16

PAYING EXCISE TAX

- Generally 2% of net investment income
- New legislation expands types of income taxed
- Estimated quarterly payments
- Reduced to 1% based on payout history
- Strategic grantmaking can lead to savings

17

FEDERAL LAWS FOR PRIVATE FOUNDATIONS

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18

SELF-DEALING RULES

- What is self-dealing? Definition:

“Direct or indirect transactions (often financial transactions) between a foundation and a “Disqualified Person.” ”

19

SELF-DEALING RULES

- Steps to identify self-dealing:

1. **Does the transaction involve a “disqualified person?”**
2. **Is the transaction listed as self-dealing?**
3. **Does an exception apply?**

20

SELF-DEALING RULES

1. Does the transaction involve a “disqualified person?”
 - Officers, directors, trustees, & others with similar authority
 - Substantial contributors to the foundation
 - Family members of those listed above (spouses, ancestors, descendants and their spouses, but *not* siblings)
 - Entities controlled by disqualified persons.
 - Certain government officials

21

SELF-DEALING RULES

2. Is the transaction listed as self-dealing?
 - a. Sale, exchange, or lease of property
 - b. Furnishing of goods or services for money
 - c. Lending of money or extensions of credit
 - d. Payment, compensation or reimbursement of a “disqualified person”
 - e. Transfer or use of income or assets of the foundation to a disqualified person
 - f. Payment of money or property to a government official

22

SELF-DEALING RULES

a. Sale, exchange, or lease of property between a foundation and a disqualified person is prohibited...

Does an exception apply?

- If no charge (\$0)

23

SELF-DEALING RULES

b. Furnishing of goods, services or facilities between a foundation and a disqualified person is prohibited...

Does an exception apply?

- If goods offered to foundation at no charge and for charitable purpose
- If \$ offered to d.p. on basis = to general public AND related to foundation's charitable purpose

24

SELF-DEALING RULES

c. Lending of money or extensions of credit to a disqualified person (this includes credit cards!) is prohibited...

Does an exception apply?

- If credit flows from the d.p. to the foundation, no fees/interest charged, proceeds for charitable purpose

25

SELF-DEALING RULES

d. Payment, compensation or reimbursement of a d.p. is prohibited...

Does an exception apply?

- Foundation can buy D&O insurance
- Foundation can reimburse d.p.'s for reasonable expenses related to foundation work
- Foundation can compensate a d.p. for "*personal services*" (~professional services related to the mission)
- Reasonable board fees

26

SELF-DEALING RULES

e. Transfer or use of income or assets of the foundation to a disqualified person is prohibited...

Does an exception apply?

- If benefits are incidental and tenuous
- If fundraiser tickets are for board members and staff...NO spouses or friends!

27

SELF-DEALING RULES

f. Payment of money or property to a government official is prohibited...

Does an exception apply ?

- See ASF's self-dealing primer or talk to your attorney if this comes up.

28

SELF-DEALING RULES

- Review of common issues
 - Compensation for board or staff
 - Loans (even credit cards)
 - Fulfilling charitable pledge
 - Rentals of property
 - Tickets to fundraisers

29

SELF-DEALING V. CONFLICTS OF INTEREST

- Self-dealing is PROHIBITED
- Conflicts of interest can be MANAGED
 - What are conflicts of interest?
 - Conflicts of Interest Policy
 - Conflicted person can share information
 - Conflicted person might not be part of final discussion
 - Conflicted person should not vote
 - Document recusal in the board minutes

30

FEDERAL LAWS FOR PRIVATE FOUNDATIONS

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31

MANDATORY DISTRIBUTION (5% PAYOUT)

- Calculated on Form 990-PF
- If >5% in a given year, creates rollover
- Extension for new foundations

32

MANDATORY DISTRIBUTION (5% PAYOUT)

o What may be included:

- All grants to 509(a)(1) & (a)(2) charities, non-charities
- eligible individuals, through an IRS pre-approved process
- Direct charitable activities
- Reasonable & necessary administrative expenses related to grantmaking
- Assets used to conduct charitable purpose (such as buying a computer for grant-tracking)
- Program Related Investments (PRIs)
- Charitable set-asides pre-approved by the IRS

33

MANDATORY DISTRIBUTION (5% PAYOUT)

o What may not be included?

- Investment-related expenses (management fees, etc.)
- Grants to *certain* supporting organizations (509(a)(3) public charities)

34

FEDERAL LAWS FOR PRIVATE FOUNDATIONS

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35

EXCESS BUSINESS HOLDINGS

- Private foundations may not own more than a small percentage of any business together with disqualified persons

- 2%, 20%, 35%, and 3 exceptions

36

FEDERAL LAWS FOR PRIVATE FOUNDATIONS

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 6. Taxable Expenditures

37

JEOPARDIZING INVESTMENTS

- Foundations that have investments that “jeopardize the carrying out of its exempt purposes” may be penalized
- Prudent Investor Rule – broadened range of acceptable investments; policies, procedures and due diligence required
- Program Related Investments (PRIs) are not considered jeopardizing investment

38

FEDERAL LAWS FOR PRIVATE FOUNDATIONS

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 6. **Taxable Expenditures**

39

TAXABLE EXPENDITURES

- What are taxable expenditures? Definition:

“Any expenditure that is *not* allowed by the IRS.”

Either the IRS prohibits the expenditure, or the foundation makes it without following requirements.

40

TAXABLE EXPENDITURES

- Don't:
 - Influence public elections, lobby, or earmark grants for lobbying (legislative or electioneering)
 - Grants to individuals without prior approval of procedures
 - Grants to non-charitable organizations without expenditure responsibility
- But you CAN:
 - Fund charitable organizations that also lobby
 - Support non-partisan research and make the results available to the public

41

PENALTIES FOR VIOLATING PRIVATE FOUNDATION RULES

- “Excise taxes” ~ prohibition
 - Initial (on foundation, sometimes on foundation managers, and disqualified persons)
 - Additional (if late)
 - Involuntary termination of foundation (if willful)

42

GOOD GUIDANCE AND PROTECTION


- Experienced, vetted legal & tax advisors
- D&O and other insurance
- Good governance policies and procedures
- ASF
 - Professional Directory of Foundation Advisors
 - Q&A service
 - Written materials (e.g., “Self-Dealing” primer and “Legal Essentials” primer)

43



Legal Issues in the Grantmaking Cycle


44



Key legal issue

- Assets dedicated to charity

45



Key non-legal issue

- Right-size and streamline the grant process

46



Legal grants

- Eligible grantees
 - Verifying grantee status

- OR -

- Eligible projects
 - Expenditure responsibility
 - Any other requirements

47



Eligible grantees

- 501(c)(3) & 509(a)(1) – publicly supported
or
501(c)(3) & 509 (a)(2) – fees supported
- 1. recognized by IRS... 2. status still current
 - IRS determination letter and IRS “publication 78”
 - IRS Exempt Organization Master List OR
 - Guidestar’s “Charity Check”
- Print & file (or save electronically) – 3 or 7 years

48



Eligible grantees, special situations

- Funding new charities (“startups”)
- When the foundation board member also sits on a charity board
- Discretionary grants made by trustee or staff


49



Eligible projects

- IRS pre-approval
 - Grants to individuals for travel, study or similar purposes (e.g., scholarships)
- Expenditure responsibility grants
 - Non-501(c)(3)'s for charitable purpose
 - Foreign organizations (*or do a “charity equivalency determination”*)
 - Other private foundations (+ *special spend out requirements*)
- Additional status documentation
 - Certain 509(a)(3) supporting organizations

50



What you can't do...except when you can!

- Lobbying
 - Influencing public elections is always out
 - Most legislative lobbying is problematic
 - BUT – you *can* fund an organization that lobbies
 - AND – you *can* lobby in self-defense

51



What you really don't want to do

- Certain 509(a)(3) supporting organizations
 - Requires expenditure responsibility – AND – doesn't count toward payout if:
 - Any type if foundation insiders (or disqualified persons) directly or indirectly control the supported organization or the supporting organization
 - Type III – unless they are “functionally integrated”.
 - Get legal counsel!

52

What's you really can't do – it's prohibited

- Taxable expenditures
 - Influence public elections, lobby, earmark for lobbying
 - Grants to individuals for travel, study or similar purposes (including scholarships) without IRS approval of procedures
 - Grants to non-charitable organizations without expenditure responsibility

53

The grantmaking cycle

- Grant guidelines
 - LOI review & response
 - Review (board, advisors, staff)
 - **Board approval & response**
 - Grant agreement
 - Learn, discuss and file
 - Letter of inquiry (LOI)
 - Grant application
 - Site visit
 - Grant report
-

54



Grant guidelines

SMALL FAMILY FOUNDATION GRANT GUIDELINES

SMALL FAMILY FOUNDATION'S MISSION

Small Family Foundation was founded in 1971 by Mr. Small, Sr. The foundation's mission is to improve our community's scholastic, natural and neighborhood environments.

GRANTMAKING FOCUS

The Small Family Foundation supports programs that work to resolve societal and environmental problems strategically and make our world a better place. Of particular interest are efforts that reach across ethnic, racial and economic boundaries. Limited grants may be made to projects and programs of special interest to Small family members. The foundation supports activities in the following areas and organizations that work in the following areas:

- In-school and after-school programs that enhance academic achievement, provide arts education, provide recreation and athletic activities, and develop technology skills.
- Toxics and environmental protection projects.
- Conflict resolution skills education, and
- Sustainable communities development.

ELIGIBILITY & TYPES OF SUPPORT

The Small Family Foundation primarily makes grants to charitable organizations that have been recognized by the IRS as being described in Section 501(c)(3) and 509(a)(1) or 509(a)(2) of the Internal Revenue Code. The foundation tends to make grants to the following types of organizations and projects:

- General operating or capacity building for organizations with an annual operating budget less than \$1 million.
- Programs focused on direct services, and/or
- Organizations or projects for which funding may be difficult to obtain, i.e. smaller organizations with limited resources for fundraising, new projects, or grassroots programs.

Grants range from \$25 to \$250,000. Applicants may apply for one-year or multi-year grants for their project. The foundation makes limited contributions to disaster relief efforts, endowments, and capital campaigns. Although...


55



Letter of inquiry

- Optional
- Might help streamline

56



LOI review & response

- Optional – What is your foundation’s style?
 - No response
 - Personalized letters
 - Pre-printed postcards
 - Individual or automated email

57



Grant application

**SMALL FAMILY FOUNDATION
GRANT APPLICATION**

GENERAL INFORMATION

Project title: _____

Organization: _____

Contact person: _____

Title: _____

Address: _____

Phone: _____

Fax: _____

E-mail: _____

Web site: _____


INFORMATION ABOUT THE REQUEST

Date of application: _____

Amount requested: \$ _____

...etc.

58



Application review & response

- Define “success”

59



Board approval

- Only legal requirement
- Meeting minutes
- Advisory committee

60

Grant award & agreement

SMALL FAMILY FOUNDATION GRANT AWARD AND AGREEMENT

Grantee Contact, Title
Grantee
Address
City, ST Zip

Date

Re: [Grantee Project]

Dear [Grantee Contact],

It is my pleasure to inform you that the Board of Directors of the Small Family Foundation has approved a grant of [\$] to [Grantee].

The intent of the grant is for [grant purpose and goals] as described in your proposal; details are spelled out in the attached grant agreement. Please review the Grant Agreement and return both signed originals to the Small Family Foundation. We will return one of the originals to you, along with a check in the amount of the grant.

IF MULTI-YEAR: [The Small Family Foundation will make payments of [\$] annually in [years]. The first installment is enclosed. Subsequent payments will be made as stipulated in the Grant Agreement, generally within 30 days of receipt, review and approval of the annual grant report].

IF FOR GRANT GREATER THAN \$ _____ [A final report is required within 60 days of the ...

61

Grant report

SMALL FAMILY FOUNDATION GRANT EVALUATION REPORT

[FOR GRANTS \$ _____ AND ABOVE]

The following information is requested by the Small Family Foundation to help us document the activities and outcomes of your grant. Please respond to each question online when possible, or attach your responses on additional pages. If any component is not appropriate your situation, please indicate as such.

PROJECT INFORMATION

Please refer to the proposal funded by The Small Family Foundation and list the goals and objectives that you had established for the proposal period. Describe the progress toward accomplishing the goals and note the number of persons affected by your activities (as appropriate). Provide both numerical and narrative information.

Was it necessary to make any changes in the proposed project? Is the project on schedule? Have there been any staff changes? Please explain any modifications to the proposal.

Briefly summarize the project's evaluation process. How did you evaluate the project, and what did you learn from the evaluation?

What do you consider your most notable project accomplishments during the past year?
...etc.

62

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Contacts

- **Kelly Shipp Simone, Esq.**
Council on Foundations
 - 703/879-0716
 - Kelly.Simone@cof.org

- **Nina Cohen, Esq.**
Glenmede
 - 215-419-6722
 - Nina.Cohen@glenmede.com

- **Ruth Masterson, MPP**
Association of Small Foundations
 - 202-580-6560
 - Ruth@smallfoundations.org

ASF Publications

- Trustee Handbook
- Foundation Guidebook
- Primers
 - Self-Dealing
 - Legal Essentials
 - Policymaking Made Clear

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