14TH ANNUAL

Rocky Mountain TAX SEMINAR

FOR PRIVATE FOUNDATIONS

September 13-15, 2023

GROUP LIVE CPE/CLE PROGRAM

Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Pomar Foundation

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Rocky Mountain Tax Seminar
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DAY 1: WEDNESDAY, SEPTEMBER 13, 2023

8:00 AM Shuttle to Garden Pavilion, Upper Lot
Departs from Broadmoor West

8:15 AM Attendee Check-in and Breakfast
Garden Pavilion

9:00 AM Welcome
Kyle H. Hybl, President and CEO, El Pomar Foundation

9:05 AM Announcements and Introductions
Jim Hasson and Eleanor Martinez

9:10 AM Harvard and UNC: The Decisions
Jim Hasson

9:35 AM Harvard and UNC: The Implications for Private Foundations
Celia Roady

10:00 AM Break

10:15 AM Tax, Legal, and Governance Issues on Our Desks:
A Panel Discussion Among Foundation In-House Counsel
Sasha Abrams, Gordon and Betty Moore Foundation
Nishka Chandrasoma, Ford Foundation
Josh Mintz, John D. and Catherine T. MacArthur Foundation
Elizabeth Peters, Hewlett Foundation
John Tyler, Ewing Marion Kauffman Foundation

11:15 AM Break

11:30 AM How Can Founders Be Assured of Adherence to Mission
Ofer Lion

12:00 PM Lunch
Garden Pavilion

1:00 PM Practical Issues Confronting Private Foundations
Faculty

2:00 PM Closing Remarks
Maureen Lawrence, Sr. Vice President, General Counselor and Director of Community Programs, El Pomar Foundation

2:05 PM Shuttle to Broadmoor West
Departs from Garden Pavilion, Upper Lot

4:30 PM Shuttle to Penrose House
Departs from Broadmoor West

4:30 PM Welcome Reception, Penrose House – Fountain Courtyard
Cocktails and Hors d'oeuvres
**Dinner at your leisure*

6:15 PM Shuttle to Broadmoor West, Departs from Penrose House

Rocky Mountain Tax Seminar
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DAY 2: THURSDAY, SEPTEMBER 14, 2023

8:00 AM	Shuttle to Garden Pavilion, Upper Lot Departs from Broadmoor West
8:15 AM	Breakfast Garden Pavilion
9:00 AM	Announcements
9:05 AM	What Foundations Should Know About the New Clean Energy Tax Incentives Ruth Madrigal
9:30 AM	Governance Principles and Practices for Private Foundations Maureen Lawrence and Ann Batlle
10:05 AM	Preparing Foundations for IRS and AG Investigations Ofer Lion and Ruth Madrigal
10:55 AM	Break
11:10 AM	Designing and Structuring Joint PRI's Krysta Copeland
11:35 AM	Practical Ways to Deal With a Breach of Grant or PRI Agreement Celia Roady
12:00 PM	Lunch Garden Pavilion
1:00 PM	Practical Issues Confronting Private Foundations Faculty
2:00 PM	Shuttle to Broadmoor West Departs from Garden Pavilion, Upper Lot

Rocky Mountain Tax Seminar
for Private Foundations

Presented by El Pomar Foundation

DAY 3: FRIDAY, SEPTEMBER 15, 2023

8:00 AM	Shuttle to Garden Pavilion, Upper Lot Departs from Broadmoor West
8:15 AM	Breakfast Garden Pavilion
9:00 AM	Announcements and Survey Evaluations
9:10 AM	Foundation Use of Contracts Vs. Grants: Special Considerations For Research Efforts Ann Batlle
10:00 AM	Grants and Transfers to Other Foundations Jim Hasson
10:30 AM	Break
10:45 AM	What the Heck Are GLAM, TEOS and EO BMF Extract? How the Treasury and IRS Now Interpret and Communicate EO Laws Ruth Madrigal
11:10 AM	Practical Issues Confronting Private Foundations Faculty
12:00 PM	Shuttle to Broadmoor West Departs from Garden Pavilion, Upper Lot

Save the Date: September 11-13, 2024.
rmtaxseminar.org

2023 FACULTY AND SPEAKERS

James K. Hasson, Jr., a graduate of Duke Law School (J.D.) and Duke University (A.B.), is a partner in the law firm of Hasson Law Group, LLP, in Atlanta, Georgia. He has published numerous articles and speaks extensively. He has served as Chair of the faculty of the Rocky Mountain Tax Seminar for Private Foundations since it was founded. From 1987-1990, he was a member of the Exempt Organization Advisory Group to the Commissioner of the IRS. He served as an adjunct professor of law in the graduate tax program at Emory University School of Law for nearly 20 years. He was chairman of the Exempt Organizations Committee of the Tax Section of ABA and the Tax Section liaison to the Exempt Organizations Division of the IRS. He is a Fellow of the American College of Tax Counsel. He has been recognized by *Chambers USA: America's Leading Business Lawyers* since 2003; named to *The Best Lawyers in America* since 1987 in nonprofit/charities law; and selected annually for inclusion in *Georgia Super Lawyers*.

Ruth Madrigal is a principal at KPMG LLP and the leader of the Exempt Organizations group in the firm's Washington National Tax practice. Ruth has years of private practice experience, advising a broad range of exempt organizations, including private foundations and their grantees, on the tax laws governing organization and operation of charitable entities. In addition, she advises corporations and individuals on such areas as charitable giving, social impact activities, and corporate social-responsibility programs. From 2010 to 2016, Madrigal served as an attorney and policy advisor in the Office of Tax Policy at the U.S. Department of the Treasury, where she was responsible for advising the Assistant Secretary of Tax Policy on all tax matters involving tax-exempt organizations and their donors, as well as representing Treasury at public hearings and meetings with other federal agencies, foreign governments, Members of Congress, and state regulators.

Celia Roady is a partner in Morgan Lewis's Tax Practice focusing on tax and governance issues affecting tax exempt organizations. She was appointed by the Internal Revenue Service to be a member of its Advisory Committee on Tax-Exempt and Government Entities for 2010-2013. Celia has also been named by Legal Times as one of Washington, D.C.'s "leading lawyers" in the tax field and is listed in Chambers USA: America's Leading Lawyers for Business (2005–2018). She was named Best Lawyers in America - Tax Lawyer of the Year (2018), listed in Best Lawyers in America (2007–2018) and named an Actritas Star (2017-2018). She chairs the annual conference on "Representing and Managing Tax-Exempt Organizations," sponsored by the Georgetown University Law Center. In 2004-2005, Celia served on the Governance Work Group of the Panel on the Nonprofit Sector, which was convened by Independent Sector to provide comments to the Senate Finance Committee. Celia is a graduate of Duke University, Duke Law School, and Georgetown Law School (LLM).

Ann Batlle advises medical research organizations, private foundations, and public charities on tax, executive compensation and employee benefits issues, intellectual property and research matters, and grantmaking. She has worked closely with independent research organizations, major research universities and academic medical centers, and research-focused philanthropies as they seek to catalyze basic research and impact the lives and health of others through innovative partnerships and technology transfer arrangements. She also advises tax-exempt organizations on lobbying compliance, corporate governance and board interactions, related organization and complex structures, and Internal Revenue Service audits.

Maureen Lawrence is Senior Vice President, General Counsel, and Regional Partnerships Program Officer. She is a member of the Foundation's senior leadership team and manages the legal affairs of the Foundation. She also provides strategic and operational leadership for El Pomar's Regional Partnerships program.

Maureen first joined El Pomar as an intern in 2002, and then again in 2003 as a participant in the Fellowship program. She went on to earn her law degree and clerk on the US Court of Appeals for the Tenth Circuit. She has over a decade of experience as a commercial litigator. Following her clerkship, she began her career at WilmerHale in Washington D.C. before relocating to Philadelphia to practice at Hangley Aronchick Segal Pudlin & Schiller, first as an associate and then shareholder. Maureen returned to El Pomar in her current role in September 2019.

Maureen earned her bachelor's degree in history and political science from Marquette University. She earned her juris doctor from The Catholic University of America, Columbus School of Law, where she was Editor-In- Chief of the *Catholic University Law Review*.

Ofer Lion has represented nonprofits and tax-exempt organizations in a wide range of tax, transactional, corporate, governance, and fiduciary matters, including formation, mergers and acquisitions, executive compensation, international activities and affiliations, unrelated business taxable income, joint ventures, program-related investments, political activities and lobbying, audits and tax controversies, tax return review, tax -exempt bonds, and dissolutions.

He has extensively represented companies in all aspects of transactional tax matters, including mergers and acquisitions (domestic and cross-border taxable transactions, tax-free spin-offs, Section 351 transactions and corporate reorganizations), equity and debt securities finance, partnerships and private equity funds, real estate investment trusts (REITs), bankruptcy reorganizations, debt restructurings, and state and local tax issues.

Ofer has been quoted as a tax-exempt organizations authority in numerous news stories, including on NPR, by The Associated Press, and in The New York Times, The Wall Street Journal, the Los Angeles Times, Tax Analysts, The Huffington Post, Forbes.com, and Politico.com. He has taught "Tax-Exempt Organizations: Law and Practice" as an adjunct professor at the UCLA School of Law.

Krysta Copeland joined The Rockefeller Foundation in 2019 and currently serves as Vice President & Associate General Counsel. Ms. Copeland is the lawyer for the Foundation's Innovative Finance team, which structures program-related investments (PRIs) worldwide, including debt, equity, convertible grants and guarantees. By leading the implementation of PRIs, she also strengthens the Foundation's programmatic work in energy, food, health, economic equity and climate & resilience. She is the lead lawyer for Rockefeller Foundation Impact Investment Management, the Foundation's investment advisory arm. She also supports the Foundation's endowment office and serves as secretary of the Investment and PRI Committees.

Prior to joining the Foundation, Ms. Copeland was a corporate attorney at Latham & Watkins in both London and Washington, DC. She primarily represented fund sponsors and institutional investors, leading all legal aspects of fund formation, fundraising, governance and compliance.

Ms. Copeland is admitted in New York and D.C. and is a member of the National Bar Association and American Bar Association. She earned her J.D. from the Howard University School of Law and her B.A. in Political Science and Africana Studies from the University of Pennsylvania.

Seminar Policies

1. To encourage the free exchange of information through presentations, questions, and discussions, no recording of the sessions of the seminar will be allowed, whether by participants, registrants, or members of the press.

2. Every effort will be made by the faculty members to answer all of the questions posed by registrants, but with the understanding that such questions and answers do not create any attorney-client relationship with the faculty members and are provided for educational purposes only. Presentations and answers to questions are not intended to constitute legal advice or a recommended course of action in a specific organization's situation, and registrants should engage and consult qualified legal counsel before taking any action discussed during the Seminar.

3. As required by the Treasury Department, none of the written materials provided by the seminar to the registrants or others may be used in the promoting, marketing or recommending to another party any tax shelter or other transaction, arrangement or matter or for the avoidance of any penalties that may be imposed under the Internal Revenue Code or any other applicable tax law.

4. The sponsors of the seminar will, upon request, assist any registrant in obtaining professional education credit for attending the seminar, but cannot assure registrants that such credit will be provided and cannot assume any costs associated with obtaining credit of this type.

5. The Rocky Mountain Tax Seminar for Private Foundations is designed to be an informal forum for the exchange of information among speakers, trustees or directors, foundation staff members, and governmental representatives. Its purpose is to advance knowledge of and compliance with the many federal and state laws and regulations affecting private foundations and similar organizations. Experience has shown that the free and open exchange of information is inhibited if audio or video recordings are made of presentations by speakers and of question-and-answer sessions among speakers and guests. Accordingly, it is the policy of the Rocky Mountain Tax Seminar that no speaker or attendee may record the presentations or question and answer sessions, even if for one's own use, and that any speaker or attendee who violates this policy will be required to leave the seminar if he or she is unwilling to comply and to erase any recordings made contrary to this policy. El Pomar Foundation, as sponsor of the seminar, reserves the right to require any person to surrender to it any recording made in violation of this policy.

Recording Policy

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If you have any questions about these policies, please contact Jim Hasson or Maureen Lawrence. We thank you for your participation in this year’s seminar.

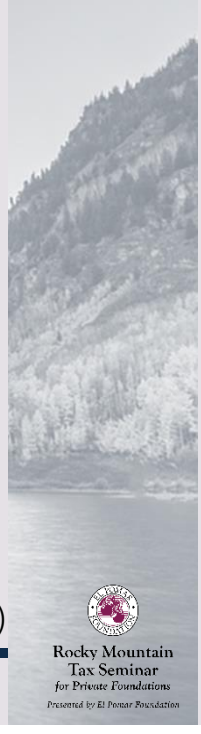
Harvard and UNC: The Decisions

September 13, 2023

JAMES K. HASSON, JR.
HASSON LAW GROUP, LLP

Harvard and UNC: The Decisions

- **BEWARE OF ABBREVIATED AND SUPERFICIAL ACCOUNTS OF JUDICIAL OPINIONS**
- **THE PARTIES TO THE TWO CASES IN LITIGATION**
  - PLAINTIFF IN BOTH CASES—STUDENTS FOR FAIR ADMISSIONS, INC.
  - DEFENDANT PRIVATE SCHOOL—PRESIDENT AND FELLOWS OF HARVARD COLLEGE (“HARVARD”)
  - DEFENDANT PUBLIC SCHOOL—UNIVERSITY OF NORTH CAROLINA (“UNC”)



Harvard and UNC: The Decisions

- **THE ISSUE AS ARTICULATED BY THE MAJORITY DECISION**: "WHETHER THE ADMISSIONS SYSTEMS USED BY HARVARD COLLEGE AND THE UNIVERSITY OF NORTH CAROLINA, TWO OF THE OLDEST INSTITUTIONS OF HIGHER LEARNING IN THE UNITED STATES, ARE LAWFUL UNDER THE EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT."

Harvard and UNC: The Decisions

- **THE DECISION OF THE COURT: THE SUPREME COURT DECIDED** —"…THE HARVARD AND UNC ADMISSIONS PROGRAMS CANNOT BE RECONCILED WITH THE GUARANTEES OF THE EQUAL PROTECTION CLAUSE."

Harvard and UNC: The Decisions

❖ **THE FACTS AS SUMMARIZED BY THE MAJORITY DECISION**

- THE ADMISSIONS PROCESS AT BOTH SCHOOLS UTILIZED AN APPLICANT'S RACE AS ONE OF SEVERAL DETERMINATIVE FACTORS IN GRANTING ADMISSION.

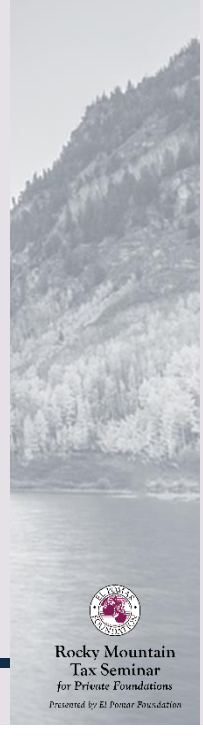
- BOTH SCHOOLS HAD USED RACE IN ADMISSIONS WITH THE INTENTION OF OBTAINING THE EDUCATIONAL BENEFITS THAT, THEY BELIEVED, RESULT FROM A RACIALLY DIVERSE STUDENT BODY.

Harvard and UNC: The Decisions

❖ **THE FACTS AS SUMMARIZED BY THE MAJORITY DECISION**

- HARVARD'S EXPRESSED OBJECTIVE WAS TO AVOID A MATERIAL REDUCTION FROM PRIOR YEARS IN THE PERCENTAGE OF ADMITTED STUDENTS WHO WERE BLACK OR HISPANIC.

- UNC'S EXPRESSED OBJECTIVE WAS TO ACHIEVE A STUDENT BODY THAT HAD PERCENTAGES OF RACIAL COMPOSITION EQUAL TO THE PERCENTAGES OF RACIAL COMPOSITION OF THE POPULACE OF THE STATE OF NORTH CAROLINA.



Harvard and UNC: The Decisions

- **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

- **1868**: FOURTEENTH AMENDMENT TO CONSTITUTION ADOPTED– SECTION 1 PROVIDES, IN PART, THAT "NO STATE SHALL . . . DENY TO ANY PERSON . . . THE EQUAL PROTECTION OF THE LAWS."
- **1880**: STRAUDER V. WEST VIRGINIA— REASONING THAT "ALL PERSONS, WHETHER COLORED OR WHITE, SHALL STAND EQUAL BEFORE THE LAWS OF THE STATES," THE SUPREME COURT REVERSED THE STATE COURT'S REFUSAL TO ALLOW A BLACK MAN, ON TRIAL FOR MURDER, TO REMOVE THE CASE TO THE FEDERAL COURTS FROM THE STATE COURT WHERE STATE LAW PROVIDED THAT BLACK MEN WERE INELIGIBLE FOR JURY DUTY.

Harvard and UNC: The Decisions

- **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

- **1886**: YICK WO V. HOPKINS— SUPREME COURT FOUND THAT EQUAL PROTECTION EXTENDED TO ALL RESIDENTS OF A STATE WITHOUT REGARD TO RACE OR ETHNICITY AND REJECTED A SAN FRANCISCO AGENCY'S DENIAL OF PERMISSION TO CHINESE CITIZENS RESIDING THERE FOR THE OPERATION OF LAUNDRIES, WHILE PERMITTING SIMILARLY SITUATED WHITE-OWNED LAUNDRIES TO OPERATE.

Harvard and UNC: The Decisions

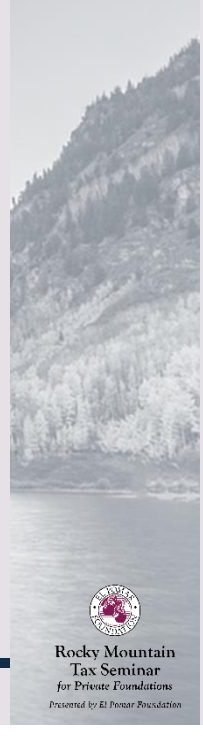
❖ **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

- **1896**: PLESSY V. FERGUSON— SUPREME COURT DECLINED TO FIND UNCONSTITUTIONAL A LOUISIANA LAW THAT REQUIRED RAILROAD COMPANIES TO SET ASIDE RAILROAD PASSENGER CARS THAT PROVIDE "SEPARATE BUT EQUAL" ACCOMMODATIONS FOR WHITE AND "COLORED" PASSENGERS.

Harvard and UNC: The Decisions

❖ **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

- **1954**: BROWN V. BOARD OF EDUCATION— SUPREME COURT CONSIDERED LITIGATION FROM THE STATES OF KANSAS, SOUTH CAROLINA, VIRGINIA, AND DELAWARE AND REVERSED PLESSY V. FERGUSON'S CONCLUSION IN HOLDING THAT "SEGREGATION OF CHILDREN IN PUBLIC SCHOOLS SOLELY ON THE BASIS OF RACE, EVEN THOUGH THE PHYSICAL FACILITIES AND OTHER 'TANGIBLE' FACTORS MAY BE EQUAL, DEPRIVE[S] THE CHILDREN OF THE MINORITY GROUP OF EQUAL EDUCATIONAL OPPORTUNITIES."



Harvard and UNC: The Decisions

❖ **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

- 1978: REGENTS OF UNIV. OF CAL. V. BAKKE— SUPREME COURT FAILED TO PRODUCE A MAJORITY OPINION; INSTEAD, SIX DIFFERENT INDIVIDUAL OPINIONS RESULTED IN A REJECTION OF THE "SET ASIDE" MINORITY APPLICANT ADMISSION PROGRAM USED BY THE MEDICAL SCHOOL AT THE DAVIS CAMPUS, AND ORDERED BAKKE'S ADMISSION, BUT DID NOT ENJOIN SCHOOL FROM EVER CONSIDERING AN APPLICANT'S RACE IF IT COULD SHOW THAT ITS ADMISSION PROGRAM WAS "NECESSARY TO PROMOTE A SUBSTANTIAL STATE INTEREST."

Harvard and UNC: The Decisions

❖ **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

- 2003: GRUTTER V. BOLLINGER— ADDRESSING A WHITE FEMALE APPLICANT'S DENIAL OF ADMISSION TO THE UNIVERSITY OF MICHIGAN'S LAW SCHOOL, SUPREME COURT DECIDED TO APPLY THE OPINION OF JUSTICE POWELL IN BAKKE AS THE APPROPRIATE STANDARD. IN BAKKE JUSTICE POWELL HAD IDENTIFIED FOUR ASSERTED JUSTIFICATIONS BY THE UNIVERSITY FOR THE USE OF RACE IN ADMISSION—

Harvard and UNC: The Decisions

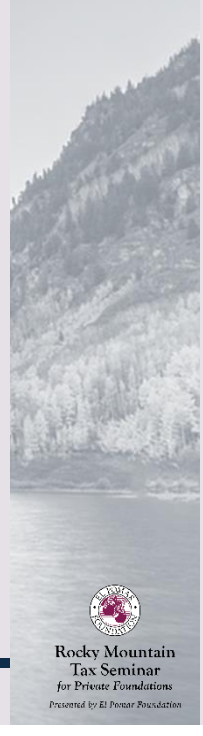
❖ **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

- REDUCING HISTORICAL DEFICITS OF TRADITIONALLY DISFAVORED MINORITIES;
- REMEDYING THE EFFECTS OF SOCIETAL DISCRIMINATION;
-
- INCREASING MEDICAL CARE IN UNDERSERVED AREAS; AND
- OBTAINING THE EDUCATIONAL BENEFITS THAT ARISE FROM A RACIALLY DIVERSE STUDENT BODY.
- IN BAKKE, JUSTICE POWELL REJECTED THE FIRST THREE BUT ACCEPTED THE FOURTH. IN GRUTTER, THE COURT FOUND THAT THE SCHOOL SATISFIED THIS FOURTH TEST.

Harvard and UNC: The Decisions

❖ **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

2013: FISHER V. UNIV. OF TEX. AT AUSTIN— SUPREME COURT DISAGREED WITH THE DECISION OF THE COURT OF APPEALS IN A CASE BROUGHT BY A CAUCASIAN FEMALE ASSERTING A DENIAL OF EQUAL PROTECTION IN THE UNIVERSITY'S USE OF RACE IN ITS ADMISSIONS PROCESS IN AN EFFORT TO ACHIEVE A "CRITICAL MASS" OF MINORITY STUDENTS. THE CASE WAS REMANDED TO THE LOWER COURT TO USE THE CORRECT STANDARD ESTABLISHED BY THE GRUTTER DECISION—THE USE OF RACE AS A NECESSARY FACTOR TO SECURE THE EDUCATIONAL BENEFITS OF A DIVERSE STUDENT BODY—RATHER THAN THE "GOOD FAITH EFFORTS" OF THE UNIVERSITY APPROVED BY THE LOWER COURT.



Harvard and UNC: The Decisions

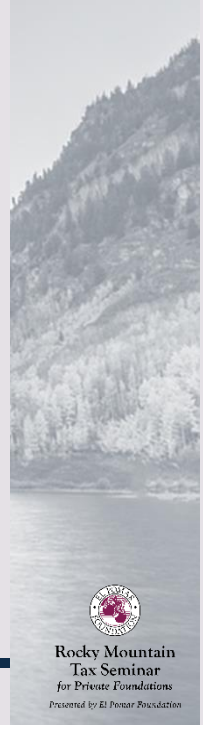
❖ **THE CHRONOLOGICAL HISTORY OF PRIOR DECISIONS**

- **2016**: FISHER V. UNIV. OF TEX. AT AUSTIN— AFTER REMAND, THE SUPREME COURT UPHELD THE UNIVERSITY'S DENIAL OF ADMISSION TO THE CAUCASIAN APPLICANT BECAUSE SHE MADE NO PERSUASIVE DEMONSTRATION THAT ANY OTHER ADMISSIONS PROCEDURE WOULD HAVE SUCCESSFULLY ACHIEVED THE UNIVERSITY'S "CRITICAL MASS" OBJECTIVE.

Harvard and UNC: The Decisions

❖ **DECISION OF THE COURT IN HARVARD AND UNC:**

- **WRITING FOR THE MAJORITY (A 6-3 DECISION),** JUSTICE ROBERTS DETERMINED THAT THE MOST RECENT DECISIONS OF THE SUPREME COURT ON THE ISSUE OF THE USE OF RACE IN COLLEGE ADMISSIONS, NOTABLY GRUTTER, DEMANDED THE ABSENCE OF RACE-BASED ADMISSIONS UNLESS THE COLLEGE COULD SHOW-
  - THAT THE USE OF RACE IS NECESSARY TO ACHIEVE A DIVERSE STUDENT BODY THAT IS "ESSENTIAL" TO THE COLLEGE'S MISSION, AND
  - THAT SUCH NECESSITY COULD BE ACHIEVED WITHOUT THE USE OF QUOTAS, SET-ASIDES, PERCENTAGE TESTS, OR "UNDUE HARM" TO NON-MINORITY APPLICANTS.



Harvard and UNC: The Decisions

❖ **DECISION OF THE COURT IN HARVARD AND UNC:**

- MOREOVER, JUSTICE ROBERTS CONCLUDED THAT ALL RECENT DECISIONS DEMANDED A TERMINAL POINT, AN OPERATION FOR ONLY A LIMITED PERIOD OF TIME, WHICH GRUTTER SET AT 25 YEARS, CLOSE AT HAND IN 2023, AND THAT NEITHER HARVARD NOR UNC HAD ANY ESTABLISHED TIMEFRAME FOR CESSATION OF THE USE OF RACE IN ADMISSIONS.

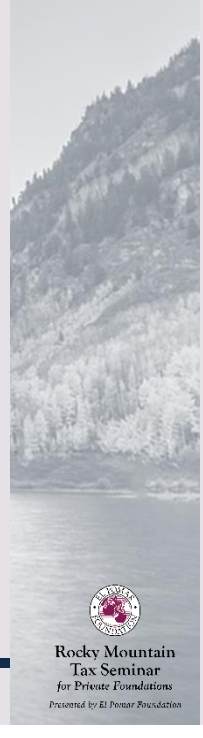
- JUSTICE ROBERTS ALSO WROTE THAT EQUAL PROTECTION OF THE LAW REQUIRES TREATING EACH CITIZEN AS AN INDIVIDUAL, NOT AS A MEMBER OF A RACIAL, RELIGIOUS, SEXUAL OR NATIONAL CLASS.

Harvard and UNC: The Decisions

❖ **DECISION OF THE COURT IN HARVARD AND UNC:**

- APPLYING THESE STANDARDS, THE MAJORITY FOUND THAT NEITHER HARVARD NOR UNC COULD DEMONSTRATE NECESSITY, THE ABSENCE OF HARM TO WHITE OR ASIAN-AMERICAN APPLICANTS, OR ANY EXPECTATION THAT ITS CONSIDERATION OF RACE WOULD EVER END.

- IN A FOOTNOTE THAT DREW THE WRATH OF THE DISSENTING JUSTICES, THE MAJORITY OPINION NOTED THAT A DIFFERENT DECISION MIGHT RESULT IF THE NATION'S MILITARY ACADEMIES WERE BEFORE THE COURT, BUT THAT WAS NOT BEING DECIDED.



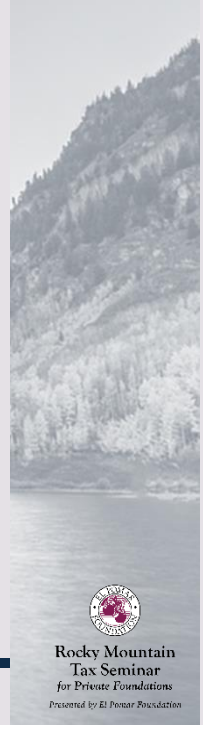
Harvard and UNC: The Decisions

- **THE REASONING OF THE MAJORITY DECISION**
- **THE CONCURRING OPINION OF JUSTICE THOMAS (58 PAGES)**--JUSTICE THOMAS AGREED WITH THE MAJORITY OPINION BUT AUTHORED AN EXTENSIVE HISTORICAL ANALYSIS TO REJECT THE PROPOSITIONS THAT:
- THE CONSTITUTION'S EQUAL PROTECTION CLAUSE PERMITS GOVERNMENTAL INEQUALITY TO OVERCOME SOCIETAL INEQUALITY, AND
- AN UNPROVEN LINK BETWEEN IMPROVED EDUCATIONAL OUTCOMES AND RACE, BY ITSELF, CAN BE A JUSTIFICATION FOR GOVERNMENTALLY-SANCTIONED UNEQUAL TREATMENT OF INDIVIDUALS OF DIFFERENT RACES.

Harvard and UNC: The Decisions

- **THE REASONING OF THE MAJORITY DECISION**

- **THE CONCURRING OPINION OF JUSTICE GORSUCH, JOINED BY JUSTICE THOMAS (25 PAGES)**—BECAUSE THE COMPLAINT WAS BASED ON ALLEGED VIOLATIONS OF BOTH THE FOURTEENTH AMENDMENT TO THE CONSTITUTION AND TITLE VI OF THE CIVIL RIGHTS ACT OF 1964, THE COURT SHOULD HAVE ADDRESSED THE LATTER AS WELL AS THE FORMER, DESPITE THE INATTENTION GIVEN TO THE CIVIL RIGHTS ACT BY ALL PARTIES. THE RESULT WOULD BE THE SAME, ACCORDING TO JUSTICE GORSUCH.



Harvard and UNC: The Decisions

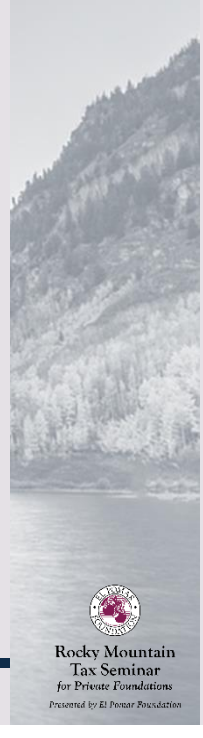
❖ **THE REASONING OF THE MAJORITY DECISION**

- **THE CONCURRING OPINION OF JUSTICE KAVANAUGH (8 PAGES**)—EMPHASIZES THE CONDITIONAL, TIME-LIMITED EFFECT OF THE GRUTTER DECISION AND THE PASSAGE OF ABOUT 50 YEARS SINCE THE BAKKE DECISION.

Harvard and UNC: The Decisions

❖ **THE REASONING OF THE DISSENTING OPINIONS**

- **THE DISSENTING OPINION OF JUSTICE SOTOMAYOR, JOINED BY JUSTICES KAGAN AND JACKSON (69 PAGES)**
- JUSTICE SOTOMAYOR ASSERTS THAT "SOCIETY IS NOT, AND NEVER HAS BEEN, COLORBLIND," SO THE CONSTITUTION'S "GUARANTEE OF RACIAL EQUALITY . . . CAN BE ENFORCED THROUGH RACE-CONSCIOUS MEANS . . . ."
- SHE ALSO AUTHORS AN HISTORICAL ANALYSIS OF THE LEGISLATION FOLLOWING THE ENACTMENT OF THE FOURTEENTH AMENDMENT AND CONCLUDES THAT THE AMENDMENT WAS REMEDIAL IN NATURE AND DESIGNED TO BENEFIT BLACK PEOPLE, NOT OTHERS.



Harvard and UNC: The Decisions

❖ **THE REASONING OF THE DISSENTING OPINIONS**

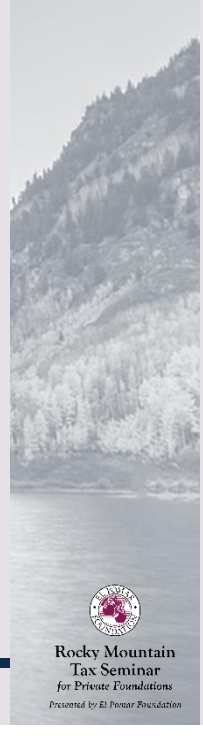
- SHE OPINES THAT NOTHING JUSTIFIES OVERRULING BAKKE, GRUTTER, AND FISHER WHILE ALLOWING OTHER RACE-CONSCIOUS BEHAVIORS BY GOVERNMENTS TO CONTINUE, AND

- SHE REJECTS THE CONCEPT OF A SPECIFIC TIME-LIMITED USE OF RACIAL CONSIDERATIONS, SAYING, "A TEMPORAL REQUIREMENT THAT RESTS ON THE FANTASY THAT RACIAL INEQUALITIES WILL END AT A PREDICTABLE HOUR IS ILLOGICAL AND UNWORKABLE."

Harvard and UNC: The Decisions

❖ **THE REASONING OF THE DISSENTING OPINIONS**

- **THE DISSENTING OPINION OF JUSTICE JACKSON,** JOINED BY JUSTICES SOTOMAYOR AND KAGAN (29 PAGES)-- JUSTICE JACKSON, JOINED BY JUSTICES SOTOMAYOR AND KAGAN, WROTE THAT THE UNITED STATES "HAS NEVER BEEN COLORBLIND" AND NEITHER SHOULD THE CONSTITUTION. SHE CONTENDS THAT THERE IS NO EQUAL PROTECTION VIOLATION IN USING THE LAW TO ATTACK THE "INTERGENERATIONAL TRANSMISSION OF INEQUALITY" THAT HAS PRODUCED "RACE-BASED GAPS [THAT] EXIST WITH RESPECT TO THE HEALTH, WEALTH AND WELL-BEING OF AMERICAN CITIZENS." SHE DISAGREES, THEREFORE, WITH JUSTICE POWELL'S CONCLUSION IN BAKKE THAT EQUAL PROTECTION OF THE LAW DOES NOT ALLOW THE LAW TO BE USED TO REMEDY "THE EFFECTS OF PAST SOCIETAL DISCRIMINATION."



Harvard and UNC: The Decisions

- **FOR CHARITABLE ORGANIZATIONS DEALING WITH THE FEDERAL TAX LAW, THE BOB JONES UNIVERSITY DECISION AND ITS EVOLUTION WERE NOT ADDRESSED IN HARVARD AND UNC DECISIONS**

  - **1983**: BOB JONES UNIVERSITY V. UNITED STATES—RELYING IN LARGE PART ON BROWN V. BOARD OF EDUCATION, SUPREME COURT DECIDED THAT "NONPROFIT PRIVATE SCHOOLS THAT PRESCRIBE AND ENFORCE RACIALLY DISCRIMINATORY ADMISSIONS STANDARDS ON THE BASIS OF RELIGIOUS DOCTRINE [DO NOT] QUALIFY AS TAX-EXEMPT ORGANIZATIONS UNDER § 501(C)(3) OF THE INTERNAL REVENUE CODE OF 1954."

Harvard and UNC: The Decisions

- **THE BOB JONES UNIVERSITY DECISION AND ITS EVOLUTION**

  - THE SUPREME COURT'S DECISION IN BOB JONES UNIVERSITY VINDICATED THE EARLIER-TAKEN POSITION OF THE IRS

  - **JULY 1970:** IRS ANNOUNCED THAT IT WOULD NO LONGER ALLOW TAX-EXEMPT CHARITABLE STATUS FOR PRIVATE SCHOOLS AT ALL EDUCATIONAL LEVELS IN THE UNITED STATES THAT PRACTICE RACIAL DISCRIMINATION.

Harvard and UNC: The Decisions

❖ **THE BOB JONES UNIVERSITY DECISION AND ITS EVOLUTION**

- **1971:** THIS 1970 ANNOUNCEMENT WAS FORMALIZED IN REVENUE RULING 71-447, WHICH STATED THAT ITS DECISION APPLIES TO ALL SCHOOL-ADMINISTERED PROGRAMS, INCLUDING SCHOLARSHIPS AND EDUCATIONAL LOANS.
- THE 1971 RULING WAS PREMISED ON THE RATIONALE THAT THE PURPOSES OF A CHARITABLE ORGANIZATION MUST NOT BE CONTRARY TO LAW OR PUBLIC POLICY AND THAT THE PUBLIC POLICY OF THE UNITED STATES HAD BEEN EXPRESSED IN BROWN V. BOARD OF EDUCATION—"TO PROHIBIT RACIAL SEGREGATION AND DISCRIMINATION IN PUBLIC EDUCATION"—AND THAT A RACIALLY DISCRIMINATORY PRIVATE EDUCATIONAL INSTITUTION CANNOT BE VIEWED AS CONFERRING A PUBLIC BENEFIT WITHIN THE CONCEPT OF CHARITY.

Harvard and UNC: The Decisions

❖ **THE SUBSEQUENT ERRATIC PATH OF IRS ANNOUNCEMENTS**

- GCM 37462 (3/17/78)—A PRIVATE FOUNDATION OPERATING A SCHOLARSHIP PROGRAM FOR CAUCASIAN STUDENTS IS NOT ENTITLED TO EXEMPTION.
- PLR 7851096 (9/25/78)—A PRIVATE FOUNDATION LIMITING ITS SCHOLARSHIPS TO STUDENTS OF FINNISH EXTRACTION IS RACIALLY DISCRIMINATORY AND ITS SCHOLARSHIP EXPENDITURES ARE TAXABLE UNDER CODE SECTION 4945.

Harvard and UNC: The Decisions

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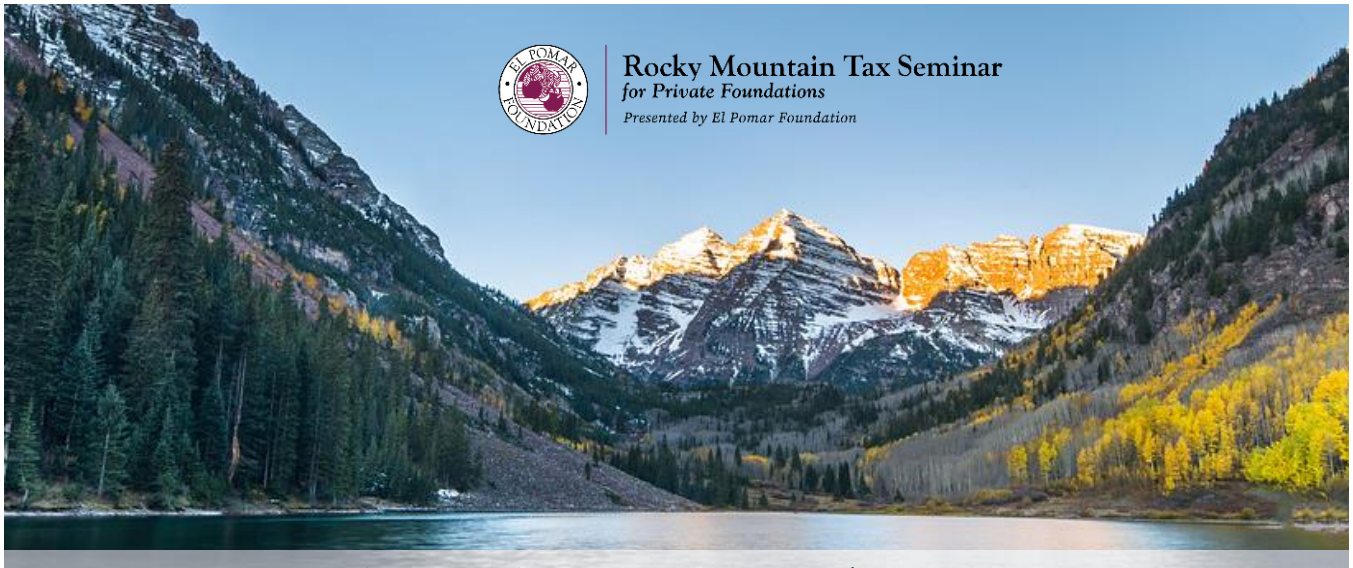


Harvard and UNC: The Decisions

September 13, 2023

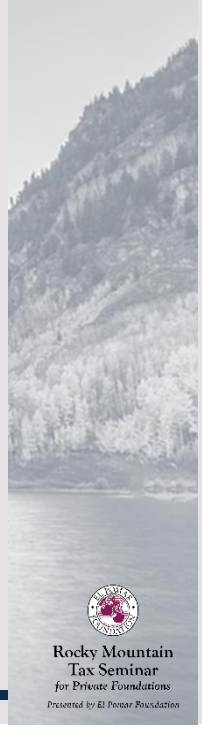
JAMES K. HASSON, JR.
HASSON LAW GROUP, LLP

Harvard and UNC: The Implications for Private Foundations

Celia Roady ~ September 13, 2023

OVERVIEW

- Overview of the Cases
- Section 1981: The Next Battleground
- Case Law Under 1981
- *Fearless Fund* Litigation
- Implications of Fearless *Fund*
- General Implications of the *Harvard and UNC* Cases
- Top-Line Implications of the *Harvard and UNC* Cases for Private Foundations
- Options for Minimizing Risk in Racial Justice Grants, PRIs, and Investments



OVERVIEW OF THE CASES

- The Supreme Court held that Harvard and UNC violated the Equal Protection Clause and, by extension, Title VI, because their practices of considering race when making college admissions decisions were not narrowly tailored to serve a compelling interest.
- The Supreme Court held that remedying the effects of societal discrimination is not a compelling interest that justifies race-based state action.
- The Supreme Court also stated that the goals of Harvard and UNC of having a diverse student body were "commendable" but could not withstand the strict scrutiny standard applicable to racial discrimination cases.

SECTION 1981: THE NEXT BATTLEGROUND

- The *Harvard and UNC* cases did not address the implications of racially based actions in the context of purely private cases. However, the concurring opinions in those cases indicated how the Supreme Court would likely rule with respect to such cases, which could arise under Section 1981, another anti-discrimination section.
- Section 1981 is a post-Civil War statute that prohibits racial discrimination in private contracts.
- The purpose of the statute was to prohibit racial discrimination against Blacks in the post-Civil War era.
- Courts have held, however, that Section 1981 prohibits any racial discrimination in private contracts, whether *against or in favor* of historically underrepresented racial groups.

CASE LAW UNDER 1981

- To date, few cases have been decided involving the impact of Section 1981 on private philanthropy.
- Several cases filed before the *Harvard and UNC* decisions are pending, including cases against Amazon and other corporations with respect to affirmative action grant programs to benefit minority racial groups.
- One case, involving Comcast, was settled on confidential terms.

FEARLESS FUND LITIGATION

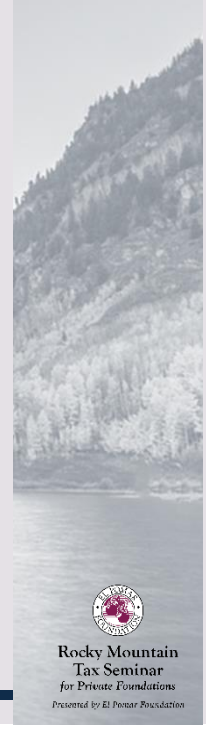
- The American Alliance for Equal Rights, a group affiliated with the plaintiffs in the *Harvard and UNC* cases, recently filed a race discrimination lawsuit in US District Court in the Northern District of Georgia against several entities affiliated with Fearless Fund Management, LLC, an Atlanta-based asset manager.
- In the *Fearless Fund* case, the plaintiff alleges that the defendant's Fearless Strivers Grant Contest violates Section 1981 because only Black women or businesses that are at least 51% owned by Black women are eligible for the grant. It is the plaintiff's position that because eligibility for the Fearless Strivers Grant Contest is restricted by race, it is inherently discriminatory.

IMPLICATIONS OF *FEARLESS FUND*

- Because Section 1981 applies broadly to any program or activity through which private parties exchange value or consideration, it is important to understand what Section 1981 permits and prohibits.
- In essence, Section 1981 prohibits organizations from considering race as a positive or negative factor when making investment decisions, funding decisions, and other contract decisions.
- In other words, Section 1981 prohibits organizations from granting benefits or priority to individuals or organizations *because of* race. An individual or business can state a claim under Section 1981 if they can show that race was one of the reasons they were not selected for a contract or opportunity.
- There are many defenses to Section 1981 claims, including standing defenses, First Amendment defenses, and, in cases challenging charitable or philanthropic grant programs like the one Fearless operates, defenses that Section 1981 does not even apply. Each of these defenses is fact-sensitive and depend upon a variety of factors, some of which vary by jurisdiction.

GENERAL IMPLICATIONS OF THE *HARVARD* AND *UNC* CASES

- Advocacy groups are likely to press new challenges to race-conscious philanthropy and private foundations that support these programs need to be prepared.
- Because litigants are likely to challenge any racial equity or DEI program that *appears* to grant advantages on the basis of race or gender, it is important that private foundations examine any programs or activities that they have created to benefit historically underrepresented groups to ensure that those programs, in policy *or* in practice, do not create unnecessary risk of challenge under anti-discrimination laws.
- These are very fact-specific issues and private foundations may wish to seek legal advice on the implications to any race-conscious programs and activities.
- The discussion that follows offers some general observations but is not a substitute for obtaining specific legal advice on particular situations.



TOP-LINE IMPLICATIONS OF *HARVARD* AND *UNC* CASES FOR PRIVATE FOUNDATIONS

- Mission: the cases have no impact on a foundation's mission.
  - A foundation can continue to have a mission to achieve racial justice/racial equity.
  - The cases may impact how the foundation chooses to carry out that mission.
- Tax-exemption: the cases have no impact on a foundation's tax-exemption.
  - A foundation that is tax-exempt on the basis of eliminating discrimination against a specific racial minority will not be in jeopardy of losing its tax-exempt status.
  - IRS regulations under Section 501(c)(3) provide that eliminating discrimination is a charitable purpose, and the private foundation regulations include an example holding that a foundation's scholarship program for a racial minority group is charitable.

TOP-LINE IMPLICATIONS FOR PRIVATE FOUNDATIONS (CONT'D)

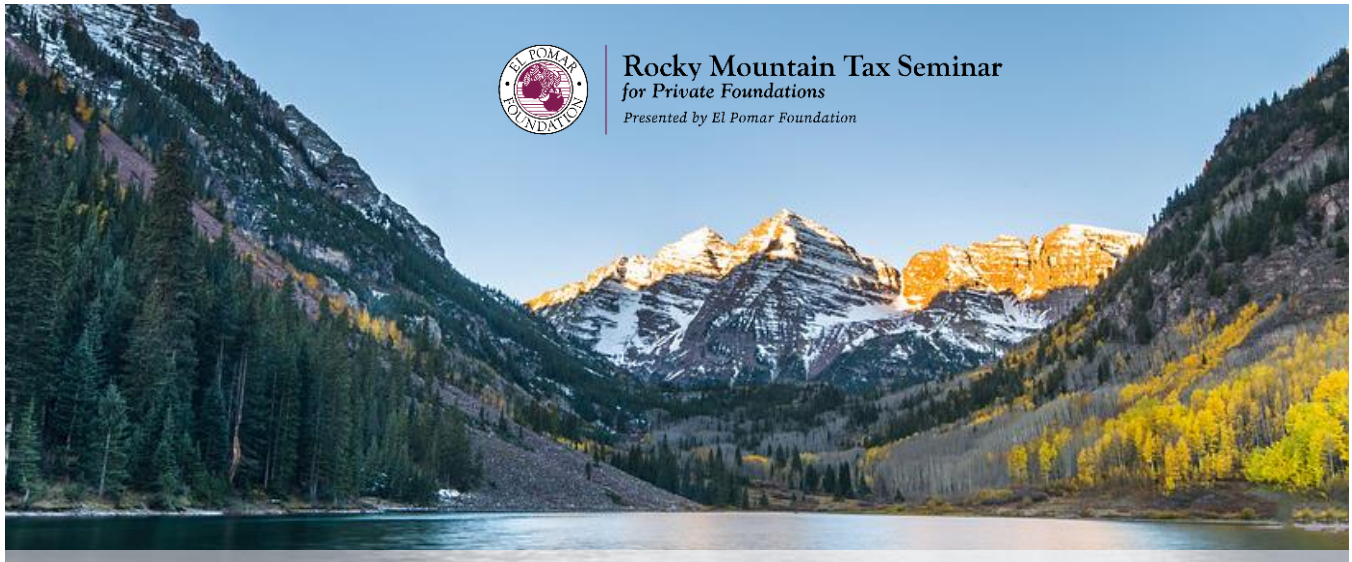
- Grants: the cases have no impact on pure grants.
  - Section 1981 applies to contracts and not to purely gratuitous transfers.
  - Whether something is a grant or a contract is a factual question and there is very little guidance.
  - Expenditure responsibility grants, in particular, might be subject to challenge under Section 1981 based on the required provisions in the grant agreement.
- Program-Related Investments ("PRIs"): the cases may impact private foundation PRIs.
  - Since PRIs are structured as investments, albeit for charitable purposes, Section 1981 may be applicable.

TOP-LINE IMPLICATIONS FOR PRIVATE FOUNDATIONS (CONT'D)

- Investments: the cases may impact private foundation investments.
    - Section 1981 may apply to private foundation investment programs that target minority investment managers or companies.
- Data collection: the cases should not impact the collection of data if such data is not used for decision-making purposes.
    - Private foundations should be free to collect data about the racial/gender composition of potential grantees, PRI recipients and vendors provided that such data is not used to make race-based decisions.

OPTIONS FOR MINIMIZING RISK IN RACIAL JUSTICE GRANTS, PRIS, AND INVESTMENTS

- Avoid race-based selection.
    - Section 1981 applies only if race is a basis for selecting or excluding recipients.
- Broaden the selection criteria.
    - Section 1981 applies only to race-based selection.
    - Broadening the class of potential recipients may minimize risk, even if the class is likely to include a substantial number of a particular racial minority.
- Target HBCUs and similar organizations.
    - Section 1981 does not apply to a racially neutral contract, even if the contracting party serves substantial numbers of a particular racial group.
- Seek legal advice about specific fact patterns.



Harvard and UNC: The Implications for Private Foundations

Celia Roady ~ September 13, 2023

Rocky Mountain Institute

The Implication of the Supreme Court's Affirmative Action Decision in *Students for Fair Admissions v. Harvard* for Private Foundations and Philanthropy and Considerations for Funders to Continue Their Missions

Joshua J. Mintz[1]

The Lede

The Supreme Court's opinion[2] gutting affirmative action in higher education, while not unexpected, was still difficult for many advocates of racial justice to stomach. It effectively reversed forty-five years of precedent, whitewashed history, and minimized the continued vestiges of racist systems faced by many people of color. Subsequent actions by conservative groups suing universities, businesses, law firms, foundations, and government agencies for alleged violations of anti-discrimination laws and/or the Constitution, and written threats from politicians and States's Attorneys General suggests more battles – and perhaps pain – to come.

This reality, however daunting, does not strike a death knell for racial justice. There are steps organizations can take to pursue goals of racial equity while complying with law and seeking real change. Foundations and organizations whose missions rest on advancing social justice should not be deterred by the decision or the coordinated attacks that have followed.

This article is a follow-up to an earlier article anticipating the decision and offers reflections on possible steps a foundation or other charitable organization might consider given its mission, culture, and risk tolerance. Like in the earlier article, I suggest below that the decision on how to respond to the Supreme Court's decision and the risk tolerance and opportunities available should be discussed with the board of the organization and a strategy determined with board and executive approval.

Why It Matters

The Court's opinion does not directly change the law pertaining to the work of most foundations or charitable organizations. The federal statutes[3] most directly applicable to a foundation's work were not at issue in the case: Section 1981 of the Civil Rights Act of 1866[4] which prohibits discrimination based on

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[1] For identification purposes only. This paper represents the views expressed by Joshua Mintz in his personal capacity and does not necessarily reflect the views of the MacArthur Foundation. In addition, some of the legal analysis is based on materials and conversations with several experienced outside counsel and with fellow general counsel but should not be construed as legal advice to any party. This is a complicated area and obtaining advice of experienced counsel is critical to understanding the risks involved and making informed decisions. Special thanks to Emily DeSmedt of Morgan, Lewis & Bockius LLP, Debo Adegbile of Wilmer Cutler Pickering Hale and Dorr LLP, and Jill Rosenberg of Orrick Herrington & Sutcliffe LLP whose expertise have informed my understanding and, to my friends, you know who you are who improved the article with their perspectives.

[2] Appendix 1 is a further description of the relevant parts of the Court's opinion.

[3] Foundations are also subject to state and local anti-discrimination statutes.

[4] Section 1981 was promulgated after the Civil War as a protection for Black Americans who had been systemically deprived of contractual rights based on their race. It provides in part: "All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens." Courts have interpretated it, however, to prohibit *all* discrimination based on race, including discrimination that benefits Black and other people of color who have faced discrimination.

race, color, and ethnicity in the making of contracts and Title VII which prohibits discrimination in employment.[5]

Nevertheless, the language in the majority and concurring opinions, has fueled the aforementioned barrage of threats and complaints against a range of entities.[6] This continued a pattern that began well before the *Harvard* opinion was issued and will likely continue.

It will take time for case law to emerge that will define permissible approaches as trial courts interpret relevant law and appellate courts weigh in. Another Supreme Court opinion to resolve conflicts that may emerge is also a distinct possibility. In the meantime, we can expect an array of opinions with some courts no doubt adjudicating the legality of programs through the lens of the ahistorical "colorblind" application of laws suggested by the Supreme Court in the *Harvard* opinion. This frame, in which anti-discrimination laws are applied equally to all races despite historical or current inequities and the original purposes of anti-discrimination laws, is viewed by many – including Justices Sotomayor and Jackson as reflected in their dissents in the *Harvard* case – as an unfortunate distortion of history. And some courts may yet give greater weight to the origins and purposes of the anti-discrimination laws in specific cases.

Right now, however, for foundations, the decision only materially impacts the risk of making contracts, investments, and, perhaps, certain grants *on the basis of* race. For the moment, foundations can still make *race-neutral* decisions that benefit historically underrepresented groups and can make grants or investments on the basis of other factors such as socioeconomic status, geographic location, first-generation status, or an individual or organization's commitment to diversity and equity. There will be, however, inevitable challenges plaintiffs to facially race-neutral applications on the basis that they are simply a front to achieve an otherwise illegal purpose.[7] It will be important, therefore, for organizations to implement programs carefully and avoid characterizations that would undermine the legal rationale.

There are also other defenses that foundations may rely on including that philanthropic gifts are not contracts under Section 1981, and First Amendment and standing arguments. These should be asserted after consultation with counsel in appropriate cases.

Critical Elements of the Court's Decision of Relevance to Foundations

The following observations drawn from the Court's opinions will need to be considered in other contexts beyond higher education:

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[5] Unlike these statutes, Title VI was at issue in the *Harvard* case. It prohibits discrimination on the basis of race in any program or activity receiving Federal financial and could have implications for organizations that receive any federal assistance. As indicated in Appendix 1, Justice Gorsuch wrote a concurrence that focused heavily on a textual analysis of Title VI and suggesting that Title VII which uses similar language) and implicitly Section 1981 would prohibit any use of race in matters covered by those statutes. This is not controlling but indicates his thinking about the interrelationship of the statutes.

[6] Appendix 2 reflects the range of actions already taken by various actors which is only expected to continue. A recent case garnering considerable attention is a challenge by American Alliance for Equal Rights, an organization led by Ed Blum, the same person heading Students for Fair Admissions, attacking as violative of Section 1981 a grant program launched by the Fearless Foundation, an affiliate of a venture capital firm to benefit Black women entrepreneurs. See Appendix 2 for more detail.

[7] A case that may end up before the Supreme Court out of the Fourth Circuit, Coalition for TJ v. Fairfax County School Board (4th Circuit 2023) starkly presents this question. In that case, the Court upheld a new program adopted by a highly rated high school, Thomas Jefferson, to achieve diversity by using race neutral factors in a holistic approach, such as tapping students from local schools that had not usually sent students to TJ for admission, admitting a certain percentage of students from each middle school in the district and using other experiential factors. The dissent argued, however, the program violated the 14th Amendment because based on the record of school board meetings and text and other messages, the intent was to achieve prohibited racial balancing at the expense of Asian Americans. A petition for certiorari has been filed with the Supreme Court.

- There are only two types of interests sufficiently compelling under the 14th Amendment to justify race-based government action: (1) remediating specific, identified instances of past discrimination that violated the Constitution or a statute, and (2) avoiding imminent and serious risks to human safety, like a race riot.

- Remedying the effects of *societal* discrimination does *not* constitute a compelling interest that justifies race-based government action. Consequently, a general racial underrepresentation in a particular workplace, industry, or market will likely not be sufficient to permit an entity to grant tangible benefits to certain groups, and not others, on the basis of race.

- This finding may impact negatively how courts assess the racial equity and DEI programs of private organizations because the Court has expressly held that its analysis under the Equal Protection Clause applies equally to claims under Title VI, and courts have historically interpreted other federal anti-discrimination laws, such as Section 1981 and Title VII, consistent with Title VI and the Equal Protection Clause.

- The Court's opinion casts raise questions whether a party can rely on an affirmative action plan to justify racial preferences under Section 1981 unless it can point to specific discriminatory actions it is addressing, not, for example, that an industry is lacking representation such as the private equity or investment fields. This suggests foundations should carefully assess strategies for investments and program-related investments to achieve greater assets under management by people of color as described below.

- Justice Roberts' opinion noted that the ruling does not prohibit universities from considering an applicant's discussion of how race has impacted his or her life, be it through discrimination, inspiration, or otherwise. Charitable organizations should consider how this carve-out may apply in different situations applicable to their work.

Steps for Organizations to Consider

The increased attention on the pursuit of racial equity and the Court's endorsement of a color-blind approach in assessing anti-discrimination laws suggests it is prudent for an organization to take steps now to mitigate unnecessary risk.

There is also a risk, however, of retreating from a commitment to racial equity. There are pathways to continue racial equity work and foundations committed to their mission should consider what steps they can take to advance justice within the bounds of the law.

Aspirational Goals Remain Okay; Quotas Are Not.

Aspirational goals remain acceptable so long as the methods to achieve those goals do not cross the line in using the racial identity of persons involved in the activity or organization as a factor in the decision (Justice Gorsuch's concurrence in the *Harvard* case describes the textualist approach he would bring to interpretation of Titles VI, VII, and presumably Section 1981 and asserts that if race was a "but for" factor even if there were other factors present the laws would be violated).

Setting quotas or working towards quotas is illegal. This includes, for example, setting an explicit floor or ceiling tied to racial characteristics. The difference between goals and quotas comes down to both language and implementation. Foundations should remain diligent in ensuring language and approaches respect the difference.

A Possible Approach

Given the nature of the opinion and the expected scrutiny of practices across organizations and fields, organizations should consider the following:

- An inventory and review of current approaches and DEI practices across the organization.
- Review messaging and communications.
- Develop talking points for all board and staff so that they speak with a consistent voice in describing efforts and approach. This may include focusing on race-neutral characteristics such as geography, proximity to and/or knowledge of communities we seek to serve, socio economic status, experiences of leaders that give rise to the characteristics we seek such as grit, determination, overcoming adversity, valuing diversity, equity, and inclusion, and others.
- Conduct refresher trainings for staff on Title VII, Section 1981, and related laws.
- Emphasize as part of the training the importance of consistent language in e-mails, texts, or conversations and avoiding language that suggests the characteristics used to make decisions are a way to "get-around" the prohibition on the use of race.
- Discuss with the organization's board the approach and risk tolerance and obtain feedback, input, and consensus on the approach.
- Mitigate unnecessary risk while pursuing mission.
- For foundations, consider increasing grants to allow grantees to retain counsel to assist them in ensuring their efforts are compliant with law.
- Collaborate with other organizations to address issues that arise and combine resources.

Practices Requiring Assessment

The tools to comply with the law while pursuing mission will differ depending on the activity but there are certain fundamental tenets and practices that should, for the moment at least, be legal.

Process is Critical.

Tools a foundation can use to comply with the law and mitigate risk while pursuing their mission will differ depending on the activity. One effective tool to help accomplish goals within existing law is to ensure that processes are inclusive. This means with respect to prospective grantees, vendors, investment managers, and staff, to reach out to organizations and people that will ensure a diverse pool

of candidates and encourage historically under-represented groups and people to apply for jobs, grants, contracts, and investments. Foundations and their staffs must reach outside networks that might be rooted in historical patterns that have limited inclusion of people of color.

Grantmaking

Section 1981 Does Not Apply to Gifts.

A critical issue in grantmaking is a determination whether a grant constitutes a gift, in which case, Section 1981 would not be applicable, or a contract. This analysis also pertains to the underlying work supported through grants.

There are compelling arguments that Section 1981 was never intended to apply to philanthropic grants. Even if the breadth of that argument may not convince some judges, foundations should consider assessing the terms of the grant agreement to determine whether changes might be appropriate to make it more "gift" like. Grants for general support provide additional distance for a foundation from the underlying activities of the grantee and may be seen as more of a gift than a project grant or expenditure responsibility grant depending on the terms of each agreement.

Some Organizations May Have Defenses Under the First Amendment.

Foundations and organizations should assess how they might use a First Amendment analysis to support their activities and grants made to organizations that are engaged in expressive activity protected by the First Amendment. This is a nuanced legal argument that requires consultation with experienced counsel. It is, however, supported by Supreme Court cases, including most recently, 303 Creative LLC v. Elenis (2023).[8]

The thrust of the argument is that if an organization is engaged in expressive activity, such as when it creates an "expressive work" or if being required to associate with persons or entities will undermine a message it seeks to convey, the activity will be protected by the First Amendment. The defense might also apply to the choices made by the foundation on who receives grants. *Id*. A court applying a strict scrutiny analysis would have to find application of Section 1981 furthers a compelling governmental interest and is narrowly tailored to serve that interest, a difficult hurdle to overcome.[9] The defense does have its limits, however, and an organization would be wise to establish clear principles on the use of this argument.

Investments and Impact Investments

It is likely investment subscriptions and investments in portfolio companies, whether convention or impact investments, will be considered contracts. Similarly, program-related investments made in the form of loans or guarantees would likely constitute contracts although arguments relying on the

[8] In Elenis, the Court found that a wedding website developer could lawfully refuse to make a wedding website for a gay couple despite a Colorado public accommodation law prohibiting discrimination because the action of making the website was expressive activity and forcing the developer to make a website contrary to her beliefs would be compelling speech in violation of the First Amendment. Other relevant cases include Dale v. Boy Scouts of America (2000); Janus v. Am. Fed'n of State, City, & Mun. Emps., Council 31 (2018); Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston (1995). A recent 11th Circuit case, Coral Ridge Ministries v. Amazon.com Inc., held that forcing Amazon to donate to organizations that it does support would violate its First Amendment rights in the face of a public accommodation law that prohibited discrimination. How the *Harvard* case will affect this reasoning remains to be seen.

[9] The recent case of American Alliance for Equal Rights v. Fearless Fund discussed infra and in Appendix 2 will likely test this theory.

charitable purpose may have resonance with some courts. The Supreme Court's decision also made clear that addressing general societal discrimination, as opposed to discrimination against identified persons, is insufficient to justify racial discrimination. This may make an "affirmative action plan"[10] defense or portfolio approach to justify race-based investing more problematic.

An organization might address this risk through one or more of the following approaches:

- Modifying investment criteria to be sure the organization can attract emerging managers who may lack a long-term track record or assets under management of a certain size;
- Using new networks to engage with emerging managers;
- Attending and sponsoring conferences where emerging managers are encouraged to attend; and
- Encouraging submissions of interest to the Foundation by emerging managers.

An organization can also use race-neutral criteria to help identify qualified managers who may have diverse backgrounds characteristics that would be attractive to the organization outside of race. There may be organizations who wish to take more aggressive postures to continuing their efforts to address past and current discrimination. These efforts should be discussed with counsel and agreed to by the organization's board.

Employment

A foundation should review its employment and DEI practices preferably with the assistance of qualified counsel and provide training to staff on the permitted processes, steps, and language to achieving racial equity in the workplace.

Vendor Diversity Programs

Vendor contracts are subject to Section 1981. Vendor diversity programs can have aspirational goals, but the implementation of such programs should take care to avoid using race as a basis to select a contractor. Description of the status of these efforts should also hew to the aspirational goals articulated and not suggest decisions were made because of the race of the contractor.

Demographic Data Gathering (and Use)

Over the last few years, many foundations have sought data on the diversity of grantees, vendors, and investees.

Collecting data is an important step in accountability and knowing where a foundation stands relative to goals it may have set. Foundations must, however, be sensitive that the data is not used in a manner that suggests the organization is using race as a factor in decision-making. Aggregating data at a top level and not sharing individual data with program staff is one way to mitigate the risk that the processes will be viewed as race-based.

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[10] The Supreme Court recognized in the employment context that an employer, faced with a manifest imbalance in traditionally segregated job categories, could adopt an affirmative action plan to address the imbalance by favoring the race where the imbalance existed as long as such plan was time-limited and narrowly drawn to address the imbalance without unnecessarily trammeling the rights of others. United Steel Workers v. Weber (1979) and Johnson v. Transportation Agency (1987). The Harvard opinion's failure to cite the Weber and Johnson cases and its reliance on a case decided before those cases to point to the need for specific discrimination raises questions for some advocates about the viability of this defense certainly outside the employment context.

Workplace DEI Programs

A foundation and other organizations should continue or initiate legally compliant diversity, equity, and inclusion programs consistent with their culture, history, and preferences. But foundations should be aware that DEI programs can be a target and, therefore, a careful review with experienced counsel is prudent.

What Foundations Can Do to Support Grantees and the Sector

Foundations have resources that many grantees lack and missions to further charitable purposes. Foundations can consider one or more of the following steps based on their philosophies, culture, and resources recognizing that disparate and separate efforts that splinter the field result in less effective programs and responses:

- Providing grants so that grantees can retain qualified counsel to build legally sound programs and approaches to pursue their racial equity mission.

- Establish programs that might provide free sources to grantees and others, such as a pro bono network or through payments to law firms, to assist grantees as direct charitable expenditures.

- Collaborate with other similarly situated funders to provide an overarching approach to provide funds for defense of claims, establish other resources, and support organizations that are providing resources and assistance to grantees. The Association of Black Foundation Executives and other organizations are taking steps to collect and curate resources.

- Foundations that have general counsels and legal departments should continue to work together and collaborate to help the field and their grantees while respecting the individual needs, priorities, strategies, and risk tolerances of their organizations.

- Foundations can also reach out to highly qualified counsel for advice and expertise and should do so when necessary. This is an evolving area of the law and the benefit of good counsel with expertise cannot be overstated.

- It is important for the sector to be strategic in how it approaches issues in an evolving legal environment. Stretching to achieve goals is commendable and even necessary at times. In an environment, however, where opposing groups are looking for targets and opportunities to test their theories, those committed to racial equity goals should try to avoid the oft quoted adage: "bad facts can result in bad law."

Conclusion

The Supreme Court opinion and its aftermath have reminded many that the path to racial justice was never linear. People of good will can disagree about the impact of the case and the strategies to follow in response. Foundations should, however, continue to work within the law to support their mission and the quest for social justice using all available tools.

Appendix 1

Critical Elements of the Court's Decision[1]

The Supreme Court's Holding in *Harvard* and *UNC*

In *Harvard* and *UNC*, the Supreme Court held that Harvard and UNC's race-based affirmative action programs are unlawful. Although the Court only analyzed Harvard and UNC's programs under the Equal Protection Clause, the Court held in a footnote that discrimination that violates the Equal Protection Clause also violates Title VI when the discriminating actor receives federal funding. In reaching its decision, the Court purported to apply its prior analysis from *Grutter* and its progeny, but has effectively overruled *Grutter* in several respects.[2]

i Basis for the Court's Holding that Harvard and UNC's Admissions Processes Violate the Equal Protection Clause

The Court reaffirmed that race-based decisions violate the Equal Protection Clause unless they are narrowly tailored to further compelling governmental interests. The Court held, however, that Harvard and UNC's programs do not survive strict scrutiny under that standard for several reasons.

First, the Court held that the educational benefits of a diverse student body are not a compelling interest. Harvard and UNC had argued that their admissions programs serve the government's interest in the educational benefits of a diverse study body, which the Court had recognized as compelling in *Bakke* and *Grutter*.[3] In rejecting that argument, the Court effectively overruled *Bakke* and *Grutter.*

The universities had argued that a diverse student body helped better train future leaders, better educate students through diversity and diverse outlooks, promoted the robust exchange of ideas, broadened understanding, and prepared engaged and productive citizens. Notably, in *Grutter*, the Court had deferred to the University of Michigan Law School's educational judgment that these same benefits of diversity were essential to its educational mission.[4] In contrast, the Court has held in *Harvard* and *UNC* that the universities' diversity goals are "commendable," but are "not sufficiently coherent for purposes of strict scrutiny" because they cannot be measured and there is no way to determine when they have been reached. Thus, the Court held that the educational benefits Harvard and UNC described "lack sufficiently focused and measurable objectives warranting the use of race." [5]

Second, the Court held that there was no "meaningful connection" between the universities' admissions processes and the educational benefits they purport to pursue because the race categories that Harvard and UNC use to measure their classes' diversity are imprecise and do not capture all groups that might constitute an underrepresented racial minority.

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[1] This summary is taken from a memorandum supplied by the law firm of Morgan, Lewis & Bockius LLP.
[2] Indeed, Justice Thomas in his concurrence and Justice Sotomayor in her dissent each acknowledged that "*Grutter* is, for all intents and purposes, overruled." *See* Thomas Concurrence, p. 58; Sotomayor Dissent, p. 28.
[3] *See Grutter v. Bollinger*, 539 U.S. 306, 322 (2003).
[4] *Id.* at 328, 332.
[5] Opinion, p. 39.

Third, the Court held that Harvard and UNC's admissions processes fail strict scrutiny because they make race a "negative" factor for some applicants. The Court noted that the Equal Protection Clause prohibits using an individual's race against him. Because college admissions are a "zero-sum" game, Harvard and UNC's practices of considering race a "plus factor" for some applicants inevitably makes race a "negative" factor for other applicants who do not receive an equivalent tip.

Fourth, the Court found that the universities' processes improperly rely on and perpetuate racial stereotypes insofar as they assume that all applicants of a particular race will provide a diverse perspective that an applicant of another race will not. The Court held that the universities' admissions processes "tolerate the very thing that *Grutter* foreswore," by assuming "that there is an inherent benefit in ... race for race's sake," and that students of a particular race think alike or have the same life experiences.

Finally, the Court noted that the programs do not allow for the determination of a meaningful end point, as required under *Grutter*. The Court rejected the universities' response that the race-conscious admissions process will end when there is meaningful representation and diversity; instead, it viewed the universities' approach as "outright racial balancing" that is "patently unconstitutional." For example, through Harvard's use of racial demographics in prior classes to guide admissions, and its fairly consistent percentages of each African-American, Hispanic, and Asian-American students admitted in each of the last 10 years.

APPENDIX 2

COURT CASES

The following are some of the cases that have been filed attacking various programs as illegal under section 1981 or, with respect to government programs a, under the 14th or 5th Amendments. These cases are representative, may not reflect the latest developments in the cases and the list does not purport to capture every pending case.

- In a case that has generated considerable attention, the American Alliance for Equal Rights recently filed a race discrimination lawsuit in US District Court in the Northern District of Georgia against several entities affiliated with Fearless Fund Management, LLC (Fearless), an Atlanta-based asset manager, including its corporate foundation. In the complaint, the Plaintiff alleges that Fearless' grant program for Black female business owners violates Section 1981. The organization that filed the *Fearless* suit is affiliated with Students for Fair Admissions (SFFA), the organization that sued Harvard and UNC in the affirmative action cases the U.S. Supreme Court decided this term.

- In two recent cases, the same Plaintiff as in the above case, has sued two law firms, Perkins Coie and Morrison & Foerster for diversity fellowships maintained by the firm under Section 1981 on the basis that the fellowships were race exclusive.

- America First Legal, the conservative nonprofit organization backed by former Trump adviser Stephen Miller, has filed complaints against Nordstrom, Activision Blizzard, and Kellogg's alleging that their DEI policies constitute racial discrimination.

- In *Ultima Servs. Corp. v. U.S. Dep't of Agriculture*, the U.S. District Court for the Eastern District of Tennessee ruled on July 19, 2023, that the U.S. Small Business Administration's (SBA) and the U.S. Department of Agriculture's (USDA) use of a "rebuttable presumption" of social disadvantage for certain minority groups to qualify for inclusion in the SBA's 8(a) Business Development Program (the 8(a) Program) violates the Fifth Amendment's Due Process Clause.

- In *Moses v. Comcast* (filed in the federal District Court for the Southern District of Indiana in 2022), the plaintiffs alleged that a program provided by Comcast through which it "offers small businesses the chance to participate in a grant program offering 'resources and tools to elevate your business,' including consulting, creative production of a 30-second TV commercial, and a TV media schedule, among other things violated Section 1981 because the program was only available to businesses that are at least 51% "owned and operated by someone who identifies as Black, Indigenous, a Person of Color, or a female." The defendant argued donative intent and that the relationship involved gift(s) rather than a contract.

  The parties settled the matter after the court denied putting a preliminary injunction into place.

- In 2021, Pfizer launched a competitive Breakthrough Fellowship Program, which selects students during their junior year of college and provides a summer internship before senior year, a two-year analyst position upon graduation, a scholarship for certain two-year graduate programs, and an offer of a full-time manager-level position. In *Do No Harm v. Pfizer* (S.D.N.Y. 2022**)**, the plaintiff asserted that, because applicants to the program must "[m]eet the program's goals of increasing the pipeline for Black/African American, Latino/Hispanic and Native Americans," the program impermissibly discriminates on the basis of race in violation of Section 1981, Title VI of the Civil Rights Act of 1964, Section 1557 of the Affordable Care Act, the New York State Human Rights Law, and the New York City Human Rights Law.

  The district court dismissed Do No Harm's action, finding that the organization failed to establish that it had standing to sue on the basis of anonymous declarations from two Do No Harm members, which stated that they were "able and ready" to apply to the fellowship "if Pfizer stops" discriminating on the basis of race. The case is now on appeal before the Second Circuit.

- Two lawsuits were filed in 2020 in Oregon state court over state dollars made available only for Black entrepreneurs in Oregon. The case involving a white plaintiff was settled,[16] and the other one involving a Latina is pending without any substantive judicial pronouncements.[17]

- In 2018, Amazon launched its Delivery Services Partners Program to help entrepreneurs secure a share of profits from online orders by setting up their own companies and employing their own drivers. As part of this program, Amazon offered $10,000 grants to Black, Latinx, and Native American entrepreneurs who wished to contract with Amazon as delivery service partners. In *Alexandre, et al. v. Amazon.com Inc***.** (S.D. Cal. 2022), plaintiffs filed a proposed class-action alleging that Amazon's grant program discriminates against Asian and white partners because it is provided only to Black, Latinx, and Native American entrepreneurs. Plaintiffs allege that, in deploying a race-conscious grant program, Amazon has violated California state civil rights laws.

- In *National Center for Public Policy Research v. Schultz (E.D. Wash. 2022),* a conservative organization and shareholder challenged seven policies adopted by Starbucks, including setting hiring goals for people of color, awarding contracts to diverse suppliers and advertisers, and tying executive pay to achievement on diversity metrics. These programs are being challenged under Section 1981 of the Civil Rights Act of 1866, Title VII of the Civil Rights Act of 1964, and Washington state civil rights laws. This case was recently dismissed with the court characterizing the complaint as frivolous.

- Texas A&M launched a program, called the Accountability, Climate, Equity and Scholarship Fellows Program, to improve its hiring of diverse mid-level faculty. During the fall semester of 2021, about 60% of Texas A&M's faculty were white; only 6% were Latino, and less than 4% were Black. In *Lowery v. Texas A&M* (S.D. Tex. 2022), a white male finance professor at the University of Texas at Austin sued Texas A&M, alleging that the University's hiring program impermissibly discriminates on the basis of race and sex, in violation of Title VI of the Civil Rights

[16] *Great Northern Res., Inc. v. Coba*, Case No. 3:20-cv-01866-IM (U.S.D.Ct. D. Or.). Settlement referenced in Cocina Cultura LLC v. Oregon Dep't of Admin. Servs., Case No. 3:20-cv-01866-IM (Lead); Case No. 3:20-cv-02022-IM (Trailing), 2021 U.S. Dist. LEXIS 162629 (U.S.D.Ct. D.Or., August 27, 2021).

[17] *Cocina Cultura LLC v. Oregon Dep't of Admin. Servs.,* Case No. 3:20-cv-01866-IM (Lead); Case No. 3:20-cv-02022-IM (Trailing)**,** 2021 U.S. Dist. LEXIS 162629 (U.S.D.Ct. D. Or., August 27, 2021**).**

Act of 1964, Title IX of the Education Amendments of 1972, and the Equal Protection Clause of the 14th Amendment.

LETTERS AND OTHER ACTIONS

Senator Cotton Warns Top Law Firms about Race-Based Hiring Practices, July 17, 2023
(Press Release, includes template letter to law firms below re race-based hiring quotas and benchmarks as part of DEI initiatives)

- Akin Gump Strauss Hauer & Feld
- Allen & Overy
- Baker Donelson
- Baker McKenzie
- Cleary Gottlieb Steen & Hamilton
- Clifford Chance
- Cooley LLP
- Covington & Burling
- Davis Polk
- Debevoise & Plimpton
- Dechert LLP
- Dentons US LLP
- DLA Piper
- Eversheds Sutherland
- Freshfields Bruckhaus Deringer
- Gibson, Dunn & Crutcher
- Goodwin Procter
- Greenberg Traurig
- Herbert Smith Freehills
- Hogan Lovells
- Holland & Knight
- Jones Day
- King & Spalding
- Kirkland & Ellis
- K&L Gates
- Latham & Watkins LLP
- Linklaters LLP
- Mayer Brown
- McDermott, Will & Emery
- Milbank LLP
- Morgan, Lewis & Bockius
- Morrison & Foerster
- Norton Rose Fulbright
- Orrick, Herrington & Sutcliffe
- Paul Hastings
- Paul, Weiss, Rifkind, Wharton & Garrison
- Proskauer Rose LLP
- Quinn Emanuel Urquhart & Sullivan
- Reed Smith LLP
- Ropes & Gray
- Shearman & Sterling
- Sidley Austin
- Simpson Thacher
- Skadden, Arps, Slate, Meagher & Flom LLP
- Squire Patton Boggs
- Sullivan & Cromwell LLP
- Weil, Gotshal & Manges
- White & Case LLP
- Wilmer Cutler Pickering Hale & Dorr
- Wilson Sonsini
- Winston & Strawn LLP

Letter dated July 13, 2023 to Fortune 100 CEOs from States' Attorneys General re Legal Consequences of Race-Based Employment Preferences and Diversity Policies
(Sent by Attorneys General of 13 states: Kansas, Tennessee, Alabama, Arkansas, Indiana, Iowa, Kentucky, Mississippi, Missouri, Montana, Nebraska, South Carolina, and West Virginia)

- Abbott Laboratories
- AbbVie
- AIG
- Albertsons
- Allstate
- Alphabet
- Amazon
- American Express
- AmerisourceBergen
- Anthem
- Apple
- Archer Daniels Midland (ADM)
- AT&T
- Bank of America
- Berkshire Hathaway
- Best Buy
- Boeing
- Bristol-Myers Squibb
- Cardinal Health
- Caterpillar
- Centene
- Charter Communications
- Chevron
- CHS
- Cigna
- Cisco Systems
- Citigroup
- Coca-Cola
- Comcast
- ConocoPhillips
- Costco Wholesale
- CVS Health
- Deere
- Dell Technologies
- Dow
- Energy Transfer
- Enterprise Products Partners
- Exelon
- Exxon Mobil
- Fannie Mae
- FedEx
- Ford Motor
- Freddie Mac
- General Dynamics
- General Electric
- General Motors
- Goldman Sachs Group
- HCA Healthcare
- Home Depot
- HP
- Humana
- Intel
- International Business Machines
- Johnson & Johnson
- JPMorgan Chase
- Kroger
- Liberty Mutual Insurance Group
- Lockheed Martin
- Lowe's
- Marathon Petroleum
- Massachusetts Mutual Life insurance
- McKesson
- Merck
- Meta Platforms
- MetLife
- Microsoft
- Morgan Stanley
- Nationwide
- New York Life Insurance
- Nike
- Northwestern Mutual
- Nucor
- Oracle
- PepsiCo

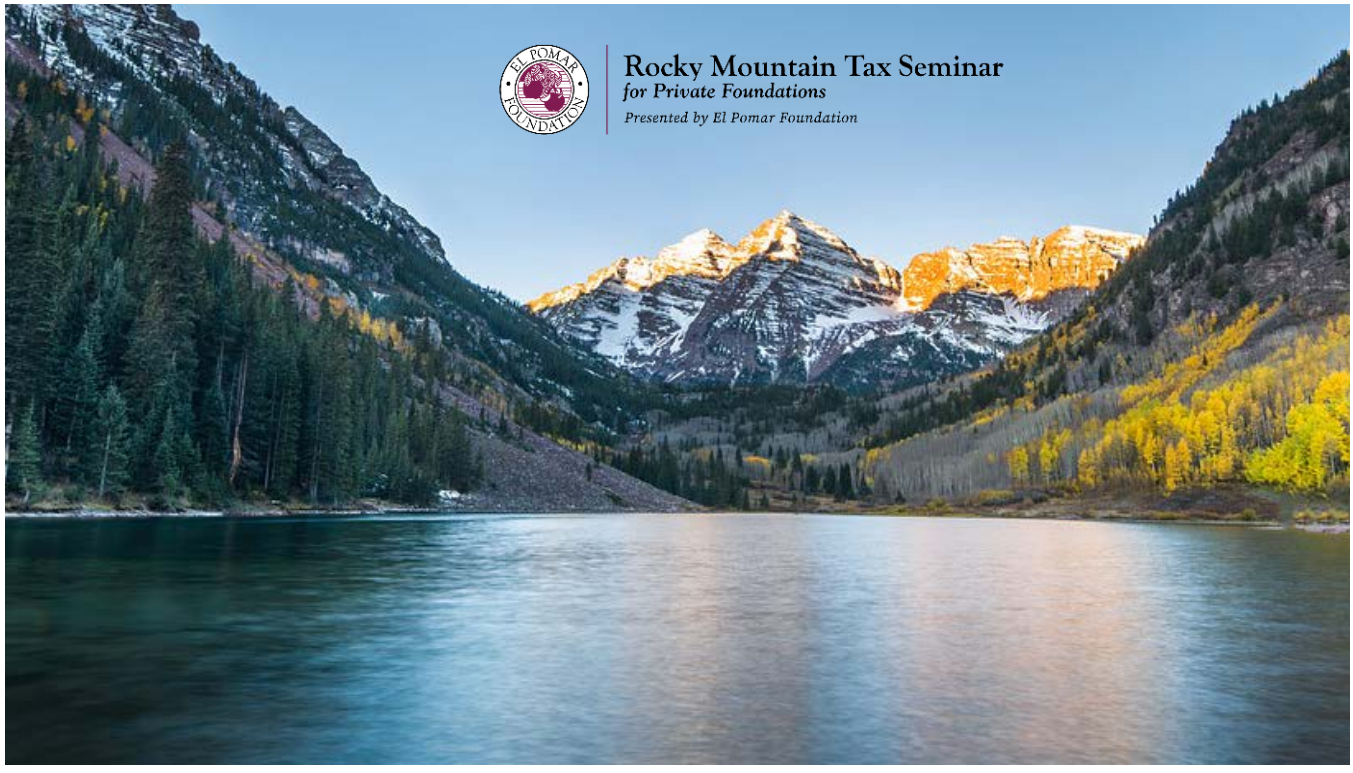
Pfizer	Raytheon Technologies	TIAA	Verizon Communications
Phillips 66	State Farm Insurance	TJX	Walgreens Boots
Plains GP Holdings	StoneX Group	Tyson Foods	Walmart
Procter & Gamble	Sysco	United Parcel Service	Walt Disney
Progressive	Target	UnitedHealth Group	Wells Fargo
Prudential Financial	Tesla	USAA	
Publix Super Markets	Thermo Fisher Scientific	Valero Energy	

Letter dated July 19, 2023 to Fortune 100 CEOs from States' Attorneys General Refuting the Foregoing Letter dated July 13, 2023
(Sent by Attorneys General of 21 states: Nevada, Arizona, California, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Jersey, New Mexico, New York, Oregon, Rhode Island, Vermont, and Washington)

Statement from EEOC Chair Charlotte A. Burrows on Supreme Court Ruling on College Affirmative Action Programs, dated June 29, 2023
(Press Release in response to Supreme Court's Decision in *Harvard* and *UNC* cases: It remains lawful for employers to implement diversity, equity, inclusion, and accessibility programs that seek to ensure workers of all backgrounds are afforded equal opportunity in the workplace)

Commentary from EEOC Commissioner Andrea R. Lucas, with Supreme Court Affirmative Action Ruling, It's Time for Companies to Take a Hard Look at Their Corporate Diversity Programs, dated June 29, 2023
(Reuters)

Students for Fair Admissions Sends Demands to 150 Colleges, Inside Higher Education, July 11, 2023
(E-mail sent to approximately 100 "flagship" public universities and approximately 50 private schools from Edward J. Blum, founder of Students for Fair Admissions (list of schools not made public))



Tax, Legal, and Governance Issues on Our Desks: A Panel Discussion Among Foundation In-House Counsel

Moderator: Josh Mintz, John D. and Catherine T. MacArthur Foundation

Panelists: Elizabeth Peters, Hewlett Foundation | Nishka Chandrasoma, Ford Foundation
Sasha Abrams, Gordon and Betty Moore Foundation | John Tyler, Ewing Marion Kauffman Foundation

Suggested Steps for an Effective Search for a New Foundation President

Joshua J. Mintz, Vice-President, General Counsel, and Secretary
John D. and Catherine MacArthur Foundation[1]

One of the critical fiduciary duties of a board of directors of a foundation is the selection of the chief executive of the foundation. This article sets forth essential steps that a board or a search committee should consider when launching a search for a president of a foundation. It is informed by the author's experience in assisting the Board of the MacArthur Foundation in several presidential search processes and from other experiences on not-for-profit boards and discussions with peers at other foundations. There is no single right way to conduct a search, but there are well-established practices that many consider "best" or necessary practices in connection with a search for a new president. Much of course will depend on the culture, history, and perspectives of the board of the organization and there is not a one size fits all approach.

There are, however, some general overriding principles that any board should keep in mind:

- The board must take ownership of the process, usually through a representative search committee,[2] and have an agreed-upon written process and timeline on which the full board agrees.
- The board must ensure the independence of the persons involved in the search and that the search is free from perceived or actual conflicts or self-interest.
- The incumbent president should not be part of the search committee or participate actively in the search, although the president can and should be consulted from time to time and would be expected to talk with the finalist(s).
- The board should determine as early as possible whether any board members may be interested in being a candidate and implement agreed upon procedures so that any interested board members are recused from the search process and considerations.
- The retention of a search firm is important to ensuring the search is, and is perceived to be, fair, inclusive, and not subject to the whims of individual board members.
- Selection of a search firm should be based on a process that includes a range of firms and is premised on clear questions to which all firms are expected to respond.
- The selection should focus on the individual(s) at the firm who will manage the search and the commitment to provide the search the requisite time among other factors.
- Good communication is important between the search committee and the board; from the board to the staff; and from the foundation to the public even as confidentiality concerns limit the amount and type of information that can be shared.

[1] Title for identification purposes only. The views expressed herein are the personal views of the author based on his experience over 28 years in assisting the Board of MacArthur in several presidential transitions and as a member of other not for profit boards.

[2] It is possible in some instances to have the full board act as the search committee, but, depending on the size of the board, this can become unwieldy and slow the process down.

- Maintaining confidentiality is paramount even though lack of information about the status of candidates can be frustrating to staff. Periodic general updates on the status, respecting confidentiality, can temper some of the frustration.

Issues to Consider

Stage I: Beginning the Process

Identify a committee to run the process.

Ordinarily, the board should appoint a search committee to manage the process, but the full board should be kept regularly informed and participate in the interviews of the finalists. Depending on the size of the board and its interest, the full board could participate as the search committee, but as noted, this can result in delays.

A search committee should be representative of the board and as diverse as possible. Directors experienced in a search process can be valuable members. Depending on the size of the board, a committee of no more than five, including the chair of the board, is usually a maximum number. The Chair of the board should query board members to determine if any board member is interested in being a candidate. If so, the interested board member should be walled off from the search committee and most discussions.

In some instances, such as a search for a university president, a search committee may contain other representatives beyond the board, such as faculty or even, at times, student representatives. For a private foundation, it has not been typical to have a member of the staff on the search committee, but this may be something for the board to consider depending on its culture and trust in the staff member. In MacArthur presidential searches, the General Counsel assisted the search committee and was present at all meetings and interviews. This alleviated the burden on the search committee and search firm and provided the committee and/or candidates a staff perspective when asked. He was not, however, a member of the committee.

Be clear about the role and authority of the search committee.

The board should be clear about the authority and role of the committee, how the board is to be kept informed, and the role of the board in the process (e.g., how often does the search committee report to the board, when does the full board meet/interview candidates, etc.).

It is a good practice to use time during an executive session at each board meeting to discuss the search process and engage the entire board.

The role of the search committee.

The search committee will have primary responsibility for the oversight of the search firm, winnowing down the list of candidates to a manageable number and recommending to the board a final slate of candidates or an individual candidate if one stands out.

The search committee should have consensus on the general parameters of the compensation, benefits, and other terms of retention for the position. This should be cleared with the board to avoid any surprises.

Who should staff the process?

It is helpful to have a trusted staff member staff the process to take the burden off the chair. This can also be a person who can provide a staff perspective as warranted. In MacArthur searches, this was the General Counsel but it can also be another more senior member of the staff who knows the board and understands the role. This would include acting as a liaison to the search firm and to staff and assisting with scheduling and help as requested.

Selection of a search firm.

Even before the launch of a formal board process, it is a good idea for a board to have a list of potential diverse search firms to consider if the need for a search arose. The board can be solicited to suggest names with whom they have had good experiences so that a pool of firms is available when the need arises.

When firms are identified, a request for proposals can be sent to the firms with a range of questions to be addressed in writing.[1] These may include the qualifications, recent experiences of similar searches, approaches to presidential searches, limitations with respect to potential candidates who may have been placed by the firm, time commitment and availability of key persons, overall philosophy, approach to diversity, expected use of psychological tests for candidates, the firm's approach to background checks and references, and other items that the committee may deem relevant.

Based on the responses, the search committee should interview a range of firms to determine the best fit. Alternatively, the decision on a search firm can be delegated to the board chair or a subset of the search committee depending on timing needs and urgency. An interview process of three to four firms with the committee will take more time because of scheduling issues and logistics.

Many firms have similar general approaches to searches of this type so the ultimate selection will often depend on the connection between the firm and the committee and specific experiences.

[1] To save time, the committee can determine to jump straight to interviews rather than a formal request for proposals but care should be taken to ensure the process is inclusive and not subject to implicit biases.

Negotiating the contract with the search firm.

Contracts with search firms are also generally similar in terms and conditions and approach. Nevertheless, there are some issues to be fleshed out before selection of a firm, including how the firm may handle conflicts, whether the firm is precluded from recruiting potential candidates because the firm placed the person in their current job, the nomination process for other names, whether the final payment is due whether or not a candidate is selected, approach to guarantees if the search is not successful, and similar issues. The firms should be asked to provide their forms of agreement as part of the selection process so any issues can be identified in advance to determine whether there are any deal breakers.

Announcing the search.

Depending on the status of the incumbent president, the board should be prepared with a simple announcement of the search, the process, and the expected timeline. The earlier the better as the announcement can help drive interest. Incumbent presidents may prefer to keep the time during which they may be viewed as a "lame duck" to a minimum, but that consideration must be balanced with a need to begin the search process. The chair should inform staff of the expected process and the board's current thinking before the announcement is made public so they feel invested in the process.

Preparing the job description.

While a search firm will assist in a job description, the board should identify the characteristics that the board desires in a new president and have ready a draft job description. This will hasten the process and provide a building block for the search firm**.**

Stage II: The Search

What is the role of the search firm?

The search committee should determine at the outset the scope of the role of the search firm and the level of involvement of the search committee in providing names, input, and oversight.

In addition to helping with the preparation of the job description, the firm will be the primary contact person for nominations and interested persons. It is important that neither the board nor the search committee engage with prospective candidates at the early stage, but rather refer all names to the search firm. Even if the board or members thereof may have in mind particular persons who would be a good fit, all names should be submitted to the search firm to be put through the same process as other candidates. The search firm should also be asked to identify any potential candidates that are off-limits to the firm because the firm had recently placed the person.

The role of staff.

Search firms should hold a session with senior staff of the organization and invite a general session with all interested staff to explain the process and obtain insight regarding the necessary characteristics for the new leader, potential names of candidates, and assessment of needs. These steps will be seen as important to all staff and provide a link to the process, particularly for senior staff who report to the president. Similarly, the incumbent president should be interviewed for an assessment of needs and characteristics.

Staff should be kept informed of the progress of the search as appropriate.

An adequate communication plan and updates to staff at relevant stages is helpful in quelling rumors and avoiding distractions. That being said, once the search kicks off in earnest, there is often not much to report, other than it is ongoing and the stage of the process. It should be explained to staff that during the process confidentiality concerns of candidates will preclude specificity. The board chair should provide written updates to the staff as appropriate.

Stage III: Selection and Announcement

Interviewing candidates.

The search committee should decide on a range of questions that should be asked of each candidate to minimize implicit bias or treating candidates differently. The people asking the questions can shift but in general the same questions should be asked even if it is expected that follow-up questions will not all be the same and the conversations will differ based on a candidates' answers or their own questions.

The board should participate in the interviews of finalists and the finalists should come prepared to respond to specific scenarios or questions.

The search committee should ideally identify a slate of final candidates (between 2-4) and the full board should participate in the final interviews as available and interested.

Candidates should be asked to respond to a very specific set of questions or scenarios in advance or to respond to a general overarching question. For MacArthur, in an earlier search, we provided several scenarios and asked candidates to respond to the scenarios. In 2014, we had directors in small groups interview selected candidates and provide reports back to the chair who shared them with the full board. In 2019, we asked finalists to make a short presentation on how they would approach a specific issue given the state of philanthropy at that time and how they would organize the Foundation's work.

In any event, the involvement of the board in the interview and selection process should be understood from the start.

Once a candidate is selected, the chair should negotiate with the prospective candidate.

Any proposed offer and the terms thereof may be communicated by the search firm or the chair. Generally, at this stage, it may be more efficient and avoid unnecessary back and forth to have the chair directly engaged in negotiations but in either event there should be a clear level of authority to which the negotiator has room to negotiate. That means the full board should understand and authorize the ceiling in terms of compensation and benefits and the chair should report back to the board.

The timing and substance of the public announcement of the successful candidate.

A public announcement should not be made until there is clear agreement on a final deal and the announcement should be cleared with the candidate and coordinated with the institution with which he/she is affiliated. Staff should be apprised of the selection and any timing considerations before a public announcement but there is often a small window of time before the public announcement to ensure confidentiality. The chair should be prepared to make the announcement to staff, to explain the reasoning and the process, and to answer questions. Consideration should be given whether any special communications should be made to grantees or other "friends" of the Foundation.

Stage IV: Transition and Commencement

The timing of the new term and the transition should be clear.

The chair and the successful candidate should decide on a commencement date. Long delays should be avoided, but the candidate may have commitments to a current employer making some delay inevitable. Depending on the reason for the selection of a new president, the board should consider whether there needs to be an interim president while the incumbent steps down. This can be sensitive and there should be clarity to this issue early in the process.

During the time of transaction, the board will need to decide whether the appointee should "shadow" any board meetings or begin to meet with staff or others while waiting to assume the role. It is important, however, to remember there should only be one president at a time. While the incumbent may be viewed as a "lame duck" the incumbent remains the president even while respecting the need to be a caretaker during this period of time.

Rough Timeline

The following is one possible timeline and is aggressive. Although this is laid out in a linear fashion, there will be times where events are happening simultaneously and it is quite possible that a selection of a candidate could occur earlier in the process than reflected below. Further, the search firm will have its own thoughts about timing and the other issues identified herein and in the memorandum.

August- Sept	Begin discussions on the structure of the search process.
	Appoint the search committee and establish the mandate, the parameters of the communications with the board, and the role of the board in final selection.
	Establish the job description and characteristics and compensation parameters. This process would be confidential among the board members.
	At the September board meeting, we should confirm the job description and the search firm. Review list of viable names from the prior search or solicit new names.
Sept – Oct	Selection of the search firm.
	Collection of names of viable candidates from the board, the senior staff, and possibly others.
	Public announcement following September board meeting.
Oct – Dec	Search firm interviews senior staff and begins to cull names from broader lists.
	Search underway.
Dec – March	Search continues and selection of final candidates. Board review of final candidate(s).
	Announcement of selection.
April – June/July	Possible transition period depending on when a new person can start.
June/July	Commencement of term of new President.

Key Issues for an Incoming Board Chair of a Private Foundation

Joshua Mintz, Vice President, General Counsel and Secretary, John D. and Catherine T. MacArthur Foundation[1]

This article identifies some of the key issues that an incoming (or current) Chair of the Board of a private foundation may wish to consider in the role.[2] Each organization is different, and context matters as does the experience of the director assuming the role of Board Chair. The history, size, culture, and community presence of the entity can also affect the allocation of tasks and role for a foundation Chair. In addition, people will approach the role of Chair based on their personal style, experience and interests and there is no one size fits all.

With those caveats in mind the following are some key areas or principles for a Board Chair to consider whether assuming a new role as Chair or for a person who has been in that role.

Knowledge of Governance Documents (and where to find them and who to ask)

A Chair should be aware of key governance documents. While the Chair does not need to be the expert on the governance documents, she should know who to ask for technical or detailed answers (often the General Counsel or Secretary). Key documents often include by-laws; Committee charters; conflicts on interest policy; expectations of the conduct of directors; evaluating the Board and directors; and directors' compensation and expense policies.

Board Culture and Keeping the Board in its Proper Role

The Chair, alongside the President, sets the tone at the top for how the Board functions, including ensuring the Board stays focused on governance and strategic functions rather than the management issues reserved to the President.

The Chair should ensure that the Board is attentive to fiscal discipline and prudent investment strategies, whether directly or through appropriate committee structures. Working with the President, the Chair should also be comfortable that the staff has the necessary expertise in these areas.

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[1] Title for identification purposes only. The views expressed herein are the personal views of the author based on 28 years at MacArthur Foundation, board member and Chair of various not for profit organizations and active engagement in the philanthropic sector. My peers and I often exchange information about best governance practices and there is a range of approaches among even the most professional organizations depending on their culture, history, and leadership. Special thanks to Martha Minow, Cecilia Muñoz, and John Palfrey, Chairs extraordinaire of private foundations for their input.

[2] For additional resources and perspective on these issues, see the appendix .

It is part of the Chair's duties and responsibilities to ensure that Board members respect their role and to step in to address instances where there may be questions to resolve whether a director has overstepped her role.

It can be helpful to periodically remind the Board about its role (noses in fingers out) and/or have a written document regarding the role of the Board and expectations of directors (MacArthur recently prepared and the Board approved such a document). Nevertheless, even with appropriate documents, the Chair, with the assistance of the President and the General Counsel, needs to be alert to potential issues and address them if they arise.

As part of these responsibilities, it remains important for there to be clarity among the Board, the President, and staff when a board member should reach out to a staff member and vice-versa and the expectations for keeping the President and Chair apprised of such discussions. Similarly, the Chair should help guide other Board members regarding engagements with grantees or in attending site visits.

Review of the Board and of Individual Board Members for Renewal of Terms

Director Assessment

A Chair and Board should also have in place an agreed upon process for reviewing individual directors and the Board as a whole. This should be documented with clear criteria for evaluation and then adhered to unless circumstances dictate a change. There are a variety of approaches that can be used depending on the degree of formality desired. For example, the process can include the Chair consulting with each board member regarding the performance of the director under review based upon identified criteria and discussing with the director up for renewal their self-assessment. If there are opportunities for improvement, the Chair can discuss any issues with the director.

An alternative can be a written evaluation form which each director fills out in confidence. The Chair can receive evaluation forms or input orally and may be assisted by the General Counsel or Secretary depending on the trust between the Chair and the specific people. Some organizations may use an outside service to assist in this process to provide greater independence.

Reviews should be done sufficiently in advance of any decision point, such as extending a term or an annual process so appropriate steps can be taken if steps are warranted.

Board Assessment of the Board

Organizations should also periodically review the performance and operations of the Board as a whole to help ensure best performance as a unit. This review could be managed by the Chair, General Counsel, or an outside service to provide the independence (the choice is a function of the individual organization, cost and relationships among board members and the Chair). This type of review is not needed every

year and should be done as needed but probably every three to four years depending on the terms of directors and the addition of new directors.

The Chair and Board should have a template for the questions to which directors are expected to respond. Examples can be found through Boardsource or other sources[3].

Compensation and Other Benefits for the Board

The Chair should ensure that any compensation payable to the Board and other benefits should be reviewed every few years. This should be based on survey data of comparable organizations so the organization understands where it stands relative to its peers and be able to justify its approach. Some foundations do not pay their directors, but provide other benefits such as matching gifts, directed gifts by directors, expense reimbursements and other perquisites.

In all, the Chair and the Board should be comfortable that the entirety of benefits provided are "reasonable" based on comparable data or any special circumstances. It is also tricky for the Board to decide to increase its own pay, but this can be done with sufficient data to support its changes and/or an opinion from an outside consultant. It is important to remember that compensation to foundation directors must be disclosed on the form 990PF and that many other not for profit organizations do not compensate their directors.

Committee Assignments

Depending on the organization's bylaws and governance protocols, the Chair, in consultation with other directors and the President (and the General Counsel/Secretary), may appoint the chairs of the Board Committees and the members of those Committees. This provides leadership opportunities for other directors who may serve as Chairs and the chance to provide valuable input to the Committee's deliberations even if not the Chair. In other cases, committees may elect their own chairs with input from the Chair.

Role on Committees

In many organizations, the Board Chair serves ex officio as a member of all committees. The Chair should in any event have a working knowledge of the work, agendas, and charters of all committees and should consult regularly with the committee chairs and the president regarding the priority of the committees.

New Board Members and Transitions

The Chair should play a central role for the consideration of new Board members working with a nominating or governance committee, if there is one, or with other directors to solicit ideas and pursue

[3] Readers interested in MacArthur's form should contact the author.

potential candidates. The Chair should be clear about what is needed for the Board to function effectively, the fit of prospective candidates with the current Board, and what additional skills, temperament and expertise is needed.

The Chair should ensure the organization has a clearly defined set of characteristics or other criteria for new board members, a written process guiding selection, The organization and Chair should also have in mind the optimal number of directors so that the board can operate effectively as a whole.

The Chair should also take care that the President be kept apprised of these efforts and an opportunity for input as the President has a keen interest on the composition of the Board to whom she reports.

Some organizations use a search firm or other outside service to identify potential board members and to interview prospective candidates, at least initially. Others, including MacArthur, use the Nominating Committee, and Board (and solicit recommendations from Staff) to identify and vet candidates.

In general, the Chair should have an active and leading role in first discussing interest with potential candidates unless she determines that it is more useful for somebody else to take that task in a specific**.**

Similarly, the Chair should take care to oversee the appropriate departure of directors whose terms are ending or, for other reasons, should leave the Board before the end of a term. This can include both appropriate recognition for a job well done, as well as a steady hand in transitions that are best for the organization but that may be more difficult because of various circumstances facing the transitioning director.

Orientation of New Board Members

The Chair should be aware of the orientation process for new Board members and the Chair should check in with new Board members more frequently than with existing Board members. Some organizations use a “buddy” or “mentor” system for new board members where a specific board member is “assigned” to the new board member. Some new Board members may be very experienced directors who do not feel the need for a mentor or any oversight. Even experienced directors may benefit, however, from understanding the culture and needs of the foundation which she recently joined.

In any event, the Chair should assist a new Board member to become acclimated to the culture and approach of the Board and organization and check in periodically with new board members.

Relationships with Board Members

The Chair should consult periodically with other Board members. It is often a matter of personal style, culture, and the need to discuss issues how often this occurs between Board meetings but establishing a regular cadence is a good practice. This helps avoid surprises, allows the Chair to understand individual’s

perspectives and helps identify understand problems that can be addressed before they ripen into significant issues.

The Chair Role at Board meetings

The Chair and President should have consensus on the orchestration of board meetings and who will do what. The Chair should, at a minimum, be prepared to open the meeting, moderate board discussions to allow all voices to be heard while keeping the meeting on track, and, usually, synthesize conclusions, outcomes, and next steps. The Chair must be prepared to step in as well to ensure respectful engagement among Board members and Board members and staff and, when necessary, speak with a recalcitrant or disruptive board member.

Many Chairs opt to speak last, or not at all, during discussions to provide maximum time for other directors. While this is a matter of personal preference, the Chair's perspective as a director remains important and the Chair should not hesitate to provide her own perspectives during or at the end of a discussion.

Leading Executive Sessions

The Chair should set and lead executive sessions at each board meeting to cover issues where the Board can speak freely on sensitive or confidential issues without most staff present. The agenda can be set in consultation with the President and other Board members should be invited to add any issues they wish to discuss. A separate executive session without the President present may also be helpful from time to time. Doing this more regularly helps dispel any concerns that there is something amiss in the relationship between the Board and the President.

Review of the President

The selection, oversight, review, and, if necessary, termination and replacement, of the President is one of the most important functions of the Board and the Chair. This should include an annual review and, as appropriate, a more comprehensive review at the four- or five-year mark depending on the expected length of tenure.

The Board and Chair should be clear on the process for the annual review and the respective roles of the Board and Chair. Best practices suggest that the President identify annual goals that could include near term, mid-term, and long-term goals together with her assessment of progress towards the prior year goals, challenges faced, and opportunities presented. The goals and assessment should be shared with the Chair and Board and concurrence reached on the goals.

The Chair should lead the review of the President and should consult with the Board (or depending on the size of the Board, constitute a subcommittee). An executive session without the President present is often a useful tool to ensure feedback by all Board members and allows interaction among Board

members. A Chair may prefer individual conversations with directors, but the overriding purpose is to ensure that directors fulfill their duty by providing input on the performance.

Some foundations allow for input from other parties, such as Staff through a 360-review process or outsiders who have a particular perspective that might be of value. Care should be taken to be clear about the use of such input, who will be included, and the relative weight of the feedback. This might be done every few years, if at all.

Once input is gathered, the Chair should provide necessary feedback to the President (this can be orally or in writing, but it is usually wise to have some record of the feedback and response).

The Chair should also always be alert to potential issues that could derail the success of the President or organization. Early intervention and an opportunity for the President to correct real or perceived weaknesses can often help avoid the need to make a change and ensure the long-term success of the incumbent President.

In any event, the Chair and the Board should have consensus on a succession plan[4], as well as identify the person who might temporarily take over the duties of the President if the President is incapacitated or leaves suddenly.

Determining Compensation

The Chair should also lead a review of any change in compensation. [5] If a change in compensation is warranted based on performance or change in the market, it is best practice to have data on comparable organizations from a consultant or drawn from the most recent 990PF of the comparative organizations. While there is no precise number of organizations required, a broad representative sample should be considered based on similar characteristics, including size, complexity, nature of operations and similar features. (MacArthur has used a group of roughly 16 private foundations). The data should be a reference point for deciding on compensation, with tenure, performance, and other relevant circumstances considered to arrive at a conclusion. It is helpful if the organization has articulated a compensation philosophy in advance to help guide decisions (e.g., the president should be at or above the median or the organization is comfortable being at or near the top of the comparator group depending on performance and tenure).

Relations with the President and planning for board meetings

[4] Some foundations have term limits for Presidents so being prepared to commence a search for a new President as the term nears an end is critical. In addition, a board could determine a change is warranted, a President could decide to retire earlier than expected or suffer health issues that would prompt the need for a search. For an article on the steps for a successful search, see the article by Josh Mintz, Suggested Steps to Help Ensure an Effective Search for a New President of a Foundation

[5] It is also a best practice for the Chair, or the chair of a compensation committee, to annually review the expenses of a President if the person authorizing expenditures is a person (such as the Chief Financial Officer) who reports to the President.

Establishing a constructive working relationship with the President is a critical part of the Chair's role. She should be a sounding board for the President while discussing collaboratively the levels of risk-taking, community presence, board meeting priorities and agenda, and other priorities over time. At the same time, the Chair must be able to bring a critical eye to any performance or other issues of the President to be able to help the President address issues before they ripen into deeper problems.

For these reasons, it is critical that the Chair and the President have a regular line of communication and firm understanding of the regular sequence of such discussions absent a crisis which would precipitate more frequent consultation. Many Chairs will meet, virtually or in person, with the President before each Board meeting and debrief thereafter. This is a useful device to ensure effective communications, that they are on the same page and head off any significant issues.

The Chair should be sure to keep the Board informed of any significant issues that may arise while maintaining a relationship of trust with the President.

Discussions with General Counsel

It is a good governance practice for the General Counsel to have a direct line to the Chair of the Board because the General Counsel of a foundation represents the organization although reporting directly to the President in most organizations. In theory therefore the General Counsel should have a dotted line to the Board. This can include being present during most executive sessions and the opportunity to talk to the Chair periodically. It can be helpful to have a more regular set of meetings so that a conversation does not have high stakes because it is seen as unusual by the President but rather part of good governance.

Speaking for the Foundation

In most foundations, the President is the principal spokesperson for the organization on issues germane to the organization, its mission, and values. Nevertheless, there may be times when it is necessary for the Chair to speak on behalf of the Board an implicitly the foundation. The Chair and President should coordinate messaging, including when it is necessary or important to speak out, and who should do so. The Chair and President should further develop an agreed upon process for when, if at all, the Chair and/or the Board wants to review a statement of the President before it is issued.

Changing Aspects of Philanthropy and Board Governance

There is increasing attention on philanthropy and models of governance, including who sits on boards, how the board relates to management and staff, whether specific communities are represented, and how the Board might engage with the community. The Chair, Board, and President should have a shared understanding of how the organization is approaching these issues and should speak with one voice on such matters.

Conclusion

The role of a Board Chair of a private foundation will differ depending upon the person, culture of the organization, its history and the desires of the Board and President. Even so, there are certain fundamental best practices that a wise Board Chair should keep in mind to ensure the Board operates as effectively as possible within its role and fiduciary duties.

Other Resources

There are a wide range of resources for incoming Board Chairs. This includes the following which is in no way meant to be inclusive:

Board Source (https://boardsource.org/)
Council on Foundations
National Association of Corporate Directors (https://www.nacdonline.org/)
Boardable.com
https://boardable.com/resources/board-chair/#:~:text=The%20role%20of%20the%20nonprofit,key%20executives%20and%20staff%20members
National Council on Non-Profits. https://www.councilofnonprofits.org/tools-resources/board-roles-and-responsibilities

EXPECTATIONS FOR THE CONDUCT OF THE DIRECTORS OF NOT FOR PROFIT ORGANIZATIONS

Joshua J. Mintz, Vice-President, General Counsel, and Secretary
John D. and Catherine MacArthur Foundation[1]

Not for profit organizations come in all shapes and sizes but directors of not-for-profit organizations generally have the same legal duties as defined by State law. Beyond a director's legal and fiduciary duties, organizations often have expectations for directors in terms of their conduct and behavior. These expectations can differ depending on the nature of the organization. Private foundations with significant assets and no need for fundraising have different expectations for directors than a smaller public charity that depends on outside resources to sustain itself and often expects its directors to contribute financially if they can.

This is a general outline of expectations for the conduct of directors that will need to be adjusted for the circumstances of each organization. Organizations may make different choices depending on their history, culture, needs and operations. It is hoped this outline can serve as a starting point for organizations to produce their own guidelines depending on their circumstances.

General Statement

As directors of the [insert name of organization] we aspire to the highest level of ethical conduct. We appreciate that our actions, and that of executive leadership, set the tone for the organization and may be scrutinized by our funders, the staff, the public, media, legislators, and regulators.

We will review periodically this document and any incidents or conduct that suggest action or additional guidance is necessary. We will also engage in appropriate training when necessary to ensure we are meeting expectations. And we will hold ourselves accountable to the expectations we have for each other.

If we have questions regarding any expected or actual conduct, we will raise them with the Chair, President, or counsel as appropriate.

Our Specific Commitments

A. Our Responsibilities to the Organization's Mission and Values

- *We are committed to our mission and to upholding our values and principles.*

[1] Title for identification purposes only. The views expressed herein are the personal views of the author based on his experience over 28 years as General Counsel of MacArthur and as a member of other not for profit boards. 2023.

- *We will be ambassadors for the organization in furthering our mission and values while maintaining our appropriate role as directors.*

B. **Our Conduct as Directors and Responsibilities to Each Other**

- *We will be sensitive to real and perceived conflicts of interest and make sure we follow the letter and spirit of the Conflicts of Interest Policy and other policies and law applicable to directors.*

- *We will maintain the confidentiality of sensitive, proprietary, and personal Information.*

- *We will take time to be briefed periodically on legal issues, other risks facing the organization and our fiduciary duties as directors*.

- *We will attend, participate, and be attentive in Board meetings, whenever possible, and be knowledgeable about the organization's mission, strategies, and financial affairs.*

- *We will be collaborative, cooperative, and respectful to fellow directors yet willing to dissent constructively.*

- *We will be sensitive to and respect cultural differences in our work for the organization and on any site visits we may take*.

- *We will conduct ourselves with appropriate regard for dynamics of power relationships and avoid comments or actions that could be considered inappropriate, sexual in nature, or demeaning when engaging with funders, staff, grantees, consultants, or others in our role as directors.*

C. Maintaining the Appropriate Role as Board Members With Staff

- *We will exercise the strategic and oversight role of the Board and respect the President's and the senior staff's roles in managing the organization.*

- *We will assist the Chair in the evaluation of the President's performance and participate as appropriate in the process of selecting a new President when there are transitions.*

- *We will honor the respective roles of Board, President, and staff in our interactions with grantees and be cognizant that grantees will likely view us as speaking for the organization.*

- *We will refer any concerns that staff bring to us to the President without engaging substantively with the staff member or, if we believe that the concern amounts to a whistleblower complaint, to the Chair of the Board, the Audit Committee Chair, or our Counsel.*

D. Engaging with Third Parties

- *We will refer press, grant or investment inquiries by third parties to the President or to another staff member (copying the President) when in our judgment the inquiry might be of interest to the organization without making any commitment to the inquirer about any action by the organization.*

- *We will refer media inquiries to the board chair and president or person charged with communications and not engage with media without coordinating with the organization.*

- *We will refer investigative inquiries made by governmental agencies or complaints by third parties to our Counsel.*

- *We will pass inquiries made by other funders regarding potential collaborations with the organization to the Chair of the Board and the President if we believe such discussions might be of interest to the organization.*

E. <u>Our Role as Fund Raisers and Personal Contributions</u>[2]

- As directors of a not-for-profit organization that depends on funding from third parties, we recognize our responsibilities to assist in fund raising as requested by the President or [director of development].
- As part of our responsibilities to the organization, we also recognize that we should contribute our personal funding as feasible given our own circumstances and consistent with the organization's needs and culture

[2] This section should be modified to the organization's own needs and culture regarding the expectation of personal contributions from a director.

Fiduciary Duties in Investment Matters

By Joshua Mintz, Vice President, General Counsel and Secretary, John D. and Catherine T. MacArthur Foundation. The views expressed herein are the personal views of Joshua Mintz and not attributable to MacArthur Foundation.

DATE: March 5, 2021[1]

Overview

Boards of directors of charitable organizations, particularly private foundations, are increasingly being asked to think about how their investment portfolios can align more closely with their charitable mission. In the management of an organization's investment assets, the board is a fiduciary[2] and must act consistent with the fiduciary duties of loyalty and care (or prudence).

Yet today, there is a lively debate about the scope of fiduciary duties in light of the growth of impact investing and the use of environmental, social, and governance ("ESG") factors in investing endowments. There is a spectrum of arguments regarding the scope of fiduciary duty in this context: Some assert a fiduciary is required to consider ESG factors; others argue that considering ESG factors for purposes, other than assessing the return on the investment, that is, for collateral purposes, could violate fiduciary duties. Still others argue a middle ground: that fiduciary duties do not require consideration of ESG, but fiduciaries may do so in appropriate circumstances, particularly when assessing the merits of an investment and its relationship to charitable mission. There are also ongoing efforts to redefine fiduciary duty to address the evolving considerations of the impact of investments beyond just financial return.

This debate is complicated by a number of factors: different interpretations of existing law; confusing language and inconsistent use of terms, concepts, and rationales and their application to evolving investment theory; different legal regimes in Europe and the United State regarding the scope of fiduciary duty which makes relying on European regimes problematic; and different rules applicable to different types of organizations, such as pension funds and charitable organizations.

Both ESG investing and impact investing have been used as umbrella terms with different meanings depending on the speaker and the audience. For foundations, different legal rules apply depending whether an investment is a program-related investment or a mission-related investment and yet both often fall under the rubric of impact investing. When it comes to ESG investing, there are a multitude of

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[1] Updated January 2023. The use of ESG in investment decisions and the backlash continues to evolve and may warrant further updates to this article.

[2] A fiduciary duty is the highest duty under American law. Justice Cardozo long ago described the meaning of fiduciary duty and it is still widely cited: "something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." Meinhard v. Salmon, 249 N.Y. 458, 464 (N.Y. Ct. App. 1928).

ESG factors and measurement standards across industries that contribute to confusion about the effectiveness of various strategies.

In addition, terms and approaches, such as socially responsible investing, negative and positive screens, corporate social responsibility, and divestment strategies, have evolved over time and can mean different things to different people, thereby further complicating the picture.

The rationale for using such strategies also differ across organizations. For example, while some argue investors should use ESG factors for moral or ethical reasons, others assert an ESG strategy also results in stronger investment returns than an investment program that eschews such strategy. Still others argue that all investments have impact and, therefore, investors must consider the impact of their investments more broadly across society, including on the environment. A growing number of smaller foundations also argue that investments should be used to further the mission of the organization.

Despite this confusion and differences in views, it is clear that ESG investing and other investment strategies that consider the impact of investments is a growing trend across philanthropic and commercial investments[3]. It is wise for a board to periodically carefully consider these issues as part of a review of its investment objectives within the scope of its fiduciary duties.

This paper provides a broad overview of the legal concepts and attempts to sort through the confusion so that a board has a clear understanding of the current fiduciary requirements.[4] It further suggests a framework for a board as it considers these critical questions.

The bottom line is that a board may, consistent with its fiduciary duties, adopt an investment approach that takes into account ESG factors and/or the impact of its investments provided it does so after (i) carefully considering the implications, including any impact on returns; (ii) articulating and documenting clearly its objectives, philosophy, rationale, and tactics and how they link to the foundation's expected financial returns, charitable mission, and overall objectives; (iii) monitoring performance over time; and (iv) making such changes as are necessary given performance and changing circumstances.

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[3] Most recently, beginning in 2022, there has been a strong backlash against ESG from treasurers and other financial officers in certain "red" States. The scope of that backlash and the response from ESG proponents is beyond the scope of this article. For additional context see the following article..
https://www.fundfire.com/c/3866204/502663/backlash_shakes_pension_space?referrer_module=emailReminder&_sso_code=02c53b2c75eaddeda941bc518df8cd0ad2f273ee

[4] There have been volumes of materials, articles, law review articles, and other commentary on these issues and I do not purport to cover the background or issues in-depth. A list of additional materials is available for those interested.

The Changing Landscape

Over the past ten to fifteen years, trustees have come under increasing pressure to consider ESG factors (and the potential impact of investments) in their investment decisions, including, for example, through divestment strategies and otherwise accounting for environmental or social costs and impact in making investment decisions.[1] This consideration is driven by external forces (peer pressure and commentary) and from internal trustees and staff who draw from their own experiences and knowledge as well as a desire to see more alignment between investments and mission, avoid charges of hypocrisy and not undercut grant making strategies.

Divestment strategies currently focus largely on fossil fuel companies but can also include other industries/companies such as tobacco, firearms, private prisons, and, more recently, the boycott, divestment, and sanctions movement targeting Israel companies. Prior to the use of divestment strategies focused on fossil fuels, divestment was used most prominently with respect to South Africa during the apartheid period and there is considerable debate as to its effectiveness in driving change and whether it was consistent with fiduciary duty. See Max M. Schanzenbach & Robert H. Sitkoff, Reconciling Fiduciary Duty and Social Conscience, 72 Stan. L. Rev. 381, 394 nn.56-58 (2020) [hereinafter Schanzenbach/Sitkoff].

Some proponents of impact investing suggest that fiduciary duties **require** trustees to consider the social impact of their investment decisions, including using ESG factors, while some lawyers and commentators suggest such consideration is not mandatory in all cases (and, indeed, could be a violation of fiduciary duties in some cases). Compare Susan N. Gary, Best Interests in the Long Term: Fiduciary Duties and ESG Integration, 90 U. Colo. L. Rev. 731, 734, 736 (2019) [hereinafter Gary] with Schanzenbach/Sitkoff.

Applicable Law and Evolving Context

Fiduciary Duty In Investment Matters

The law of trusts supplies the relevant fiduciary principles for trusts, pension funds, and charitable endowments. The Uniform Prudent Management of Institutional Funds Act ("UPMIFA") applies trust law to charitable endowments as a matter of state law. UPMIFA calls for the application of a series of factors for fiduciaries to consider, including an asset's special relationship to the organization's mission. These factors must be assessed and balanced as part of a comprehensive analysis. Exhibit A includes a description of the required analysis and factors.

Private foundations are also subject to the jeopardizing investment rules of section 4944 of the Internal Revenue Code that prohibits foundations from making investments that jeopardize "the carrying out of any of its exempt purposes" and require fiduciaries to exercise ordinary business care and prudence in the making of all investments so as to provide for the long-term and short-term financial needs of the foundation to carry out its exempt purposes.[2]

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[1] The use of negative screens, sometimes called socially responsible investing, to avoid companies or industries is not new. For a history, see Schanzenbach/Sitkoff at 392-393.

[2] A complete description of the jeopardizing investment rules is beyond the scope of this paper. Program-related investments are an exception to the jeopardizing investment rules.

It is largely understood that the underlying fiduciary principles require a duty of loyalty to beneficiaries and a duty of prudence (or care) in the manner in which investments decisions are made.[3] The duty of loyalty depends on the nature of the organization. With trusts, a trustee must administer the trust solely in the interest of the beneficiaries and cannot be influenced by the interest of any third person or motive other than the accomplishment of the trust. Acting with mixed motives creates an irrebuttable presumption of a breach of duty. With respect to charitable corporations, the fiduciary must act in the best interest of the beneficiary, avoid conflicts of interest, not make decisions on the basis of personal preferences or values, and not engage in self-dealing.

The duty of prudence requires a fiduciary to exercise the care and attention that a reasonable investor would exercise in a similar situation and requires a documented analysis showing the rationale for the investment, including risk/return aspects and any considerations allowable by the law applicable to the organization. Generally, absent a directive from the person setting up the trust, this requires a diversified portfolio with risk and return objectives reasonably suited to the purpose of the trust.

The application of these principles results in some differences depending on the nature of the organization. Fiduciaries of pension funds must, for example, administer assets solely for the beneficiary of the pension plans and, therefore, focus on the risk-adjusted investment return. Consideration of other collateral or social benefits at the expense of returns would potentially subject the fiduciary to damages.

On the other hand, and importantly to private foundations, the application of fiduciary duty law provides more flexibility for fiduciaries of charitable organizations, including foundations, which permits fiduciaries to consider the charitable mission of the organization when making investment decisions as explained above.[4]

An Evolving Context

Historically, in reliance on the trust principle of loyalty, many trustees of investment assets understood their duties to focus solely on maximizing the financial return of the assets in light of the risks as in the best interests of their beneficiaries. Consequently, even as interest in mission-related investing and use of ESG factors grew, some trustees were reluctant to embrace mission-related investing wherein considerations of other factors, including ESG, might play a role in the investment decision-making process rather than solely the best risk-adjusted return[5]. To address this perceived reluctance and

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[3] Some commentators assert directors also owe a duty of obedience to the terms of establishing the fiduciary's authority and a duty of impartiality (requiring fiduciaries to treat different generations of beneficiaries impartially). See Gary at 784. Professor Gary summarizes the duties as follows: a "fiduciary must treat all generations of beneficiaries impartially, must act in the best interests of the beneficiaries and not for the fiduciary's own benefit, and must follow the prudent investor standard in investing assets held by the entity. These three duties interrelate, especially for long-term trusts, pension plans, and endowments." Id. at 796.

[4] The Restatement of Law Charitable NonProfit Organizations (2022) addresses fiduciary duty in the context of investment matters in sections 2.01- 2.04. Section 2.04 addresses in particular the duties and approach in the management, investment, and expenditure of a charity's assets.

[5] In a 2018 survey of U.S. investment professionals, approximately 22% of those not using ESG factors believe that doing so would violate fiduciary duty. Schanzenbach/Sitkoff at 385, n.7. Another study found that 22% of investment professionals not considering ESG factors suggested they would do so if they had clarity that it would not conflict with fiduciary constraints. Id. It wouldn't be surprising if evolving

encourage more investment using impact principles, proponents of mission-related investing began urging a reconsideration of the historical view of fiduciary duty. Important developments included a report by the law firm of Freshfields Bruckhaus Deringer[6] (focused largely on European fiduciaries) that analyzed fiduciary duties applicable to investment decision-making and concluded that integrating ESG considerations into investment analysis was "clearly permissible" and "arguably required" and, thereafter, the establishment of the Principles for Responsible Investment, an investor initiative in partnership with the UN Environment Programme Finance Initiative and the UN Global Compact ("PRI"), that also took the view that there are "positive duties on investors to integrate ESG issues". The PRI also recently initiated a project to promote consideration by trustees of the collateral sustainability effect of their investment practices. See Schanzenbach/Sitkoff at 389, n.29.

Meanwhile, beginning roughly fifteen years ago, efforts picked up in the United States to encourage ESG investing and mission-related (and impact) investing including, through the creation of the Mission Investors Exchange, important reports and papers from FSG and Rockefeller Philanthropy Advisors, among others, addressing the legal requirements and efforts by Rockefeller Foundation and other proponents of mission-related investing. Some foundations took up the clarion call for the divestment from fossil fuel companies and pressure mounted on those foundations maintaining exposure to such assets.[7]

In addition, as a result of the growth of mission-related investing, various regulatory authorities were prompted to provide guidance, some of which added to the confusion, but others allowed for greater clarity regarding the permissible practices for fiduciaries of investment assets. For example, the Department of Labor ("DOL") issued a series of guidance for fiduciaries of pension plans in 2008, 2015, 2018, 2020, and 2022 touching upon the use of ESG or other impact factors with each one attempting to clarify the previous one. In 2020, the DOL issued revised proposed guidance which was perceived widely as skeptical of using ESG in investment decisions and received hundreds of comments. Thereafter, the final guidance largely stayed away from using the ESG language but indicated that trustees of pension funds had to focus on risk-adjusted returns and that factors (labelled "pecuniary factors")[8] that might influence those returns could be considered in that context. Then, in 2022 the Biden Administration DOL issued its final rule that, among other things, adopted a neutral approach to the use of ESG factors that permits (but does not require) the use of ESG factors when appropriate in the determination of the risk/return factors of the investment. See

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norms and law and the Restatement as described above change the results of the survey if administered again in 2023 but the ESG backlash could also muddy the waters.

[6] Asset Management Working Group of the UNEP Finance Initiative, A legal framework for the integration of environmental, social and governance issues into institutional investment (Oct. 2005), a report developed by a project team led by a British law firm, Freshfields Bruckhaus Deringer. The view that ESG consideration was **required** was a bridge too far for many U.S. professionals, but has generated support in a number of circles. It is important to note that the European Union, in general, is far more supportive of ESG investing.

[7] Divest/Invest is an effort led by the Wallace Global Fund and others encouraging foundations to divest from fossil fuel companies and reinvest in clean energy. See https://www.divestinvest.org/.

[8] See https://www.dol.gov/newsroom/releases/ebsa/ebsa20201030. Pecuniary factors are described as "any factor that the responsible fiduciary prudently determines is expected to have a material effect on risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and funding policy". As noted, the new Biden Administration rule has modified this approach.

https://www.dol.gov/newsroom/releases/ebsa/ebsa20221122. [9] in January 2023, 25 States sued to stop the implementation of the DOL rule. A final resolution of the authority of the DOL to issue the rule will likely require appellate review.

Most importantly for private foundations, the IRS provided some guidance in 2015 that clarified that foundations could consider, among a range of factors, an asset's relationship to the foundation's charitable purposes when considering investment options (essentially confirming the application of UPMIFA to the investment process). I.R.S. Notice 2015-62, 2015-39 I.R.B. 411. This was seen as an important clarification for some even though, for many lawyers in the field, the IRS only confirmed what many previously understood. The Notice provided in part:

> *When exercising ordinary business care and prudence in deciding whether to make an investment, foundation managers may consider all relevant facts and circumstances, including the relationship between a particular investment and the foundation's charitable purposes. Foundation managers are not required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as the foundation managers exercise the requisite ordinary business and prudence…. For example, a foundation will not be subject to tax under section 4944 if foundation managers who have exercised ordinary business care and prudence make an investment that further the foundation's charitable purposes at an expected rate of return that is less than what the foundation might obtain from an investment that is unrelated to its charitable purposes.*

The guidance also noted that it was consistent with the general state law requirements of UPMIFA[10]. Taken together, an investment undertaken consistent with the UPMIFA factors and section 4944 requirements, which is expected to result in a below market return, will not by itself cause a breach of duty if the investment and its intended impact is also expected to serve the purposes of the charity.

The Commercial Investment World Moves Toward ESG and a Backlash Ensues[11]

In the last five years, an increasing number of commercial investment firms have embraced the notion of investing with an eye on ESG factors or other impact. In 2020, Larry Fink, CEO of Blackrock, the investment firm with most assets under management, sent a letter heard around the investment universe informing companies that Blackrock would view a company's approach to ESG, and, particularly, climate-related issues as an important part of its investment process. See

[9] See also https://www.ropesgray.com/en/newsroom/alerts/2022/november/dol-final-rule-embraces-principles-based-approach-to-esg-factors-in-investments-and-proxy-voting#:~:text=On%20November%2022%2C%202022%2C%20the,exercise%20of%20shareholder%20rights%2C%20including

[10] In 2018, Delaware amended its prudent investor statute to become the first state to specifically address ESG investing, providing, in part, that "when considering the needs of the beneficiaries, the fiduciary may take into account the financial needs of the beneficiaries as well as the beneficiaries' personal values, including the beneficiaries' desire to engage in sustainable investing strategies that align with the beneficiaries' social, environmental, governance or other values or beliefs of the beneficiaries. 81 Del. Laws 320 § 5 (2018).

[11] But see footnote 3 infra regarding the backlash to ESG.

https://www.blackrock.com/corporate/investor-relations/2020-blackrock-client-letter: "Our investment conviction is that sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors."[12] In 2021, Mr. Fink doubled down on the importance of investing with considerations of ESG, and particularly climate, calling on all companies to "disclose a plan for how their business model will be compatible with a net zero economy." https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter. It is, of course, not only Blackrock that is pushing this view. The growth of assets under management devoted in one way or another to ESG investing is undeniable across many firms yet slowed in 2022 amidst the backlash to ESG.[13] The emerging backlash from financial officers of "red" States noted in fn3 has challenged Blackrock and Mr. Fink on the use of ESG and some states have moved money from Blackrock mandates in response and threatened other firms that are viewed as sympathetic to ESG style investing or that have limited funding of fossil fuel companies.

The Explanation of Investment Rationales Depends on a Variety of Factors

Continuing concerns about complying with fiduciary duties does help explain, however, the approach taken by a variety of fiduciaries to justify decisions whether to divest or use ESG investing. Pension funds are generally careful, therefore, to base their public explanations of potentially controversial investment decisions on the basis of an investment thesis, not an ethical or moral concern. For example, CalPERS responded to criticism that it might be violating its duties by relying on ESG factors by arguing that it used ESG factors as "an informed investor … not because they make us feel good but because there is sound economic reasoning to do so." https://www.calpers.ca.gov/page/newsroom/for-the-record/2017/slanted-study-esg-falls-apart. Similarly, some universities have framed decisions in response to student demands to divest from fossil fuels or other industries deemed objectionable on the basis of an investment thesis or a broader institutional response to the climate issue and not the morality or ethics of investing in fossil fuels.[14] See, e.g., message from President of Harvard (https://www.harvard.edu/president/news/2020/message-from-president-bacow-on-climate-change);[15] Michael Katz, Swarthmore Endowment Will Not Divest from Fossil Fuels, Chief Investment Officer, June 15, 2018, https://www.ai-cio.com/news/swarthmore-endowment-will-not-divest-fossil-fuels/; and Board of Trustees commits to accelerating transition to net-zero greenhouse gas emissions, reports major reduction in fossil fuel investments, Stan. News, June 12, 2020,

[12] In a similar vein, more recently, the Business Roundtable announced a reconceptualization of the purpose of a corporation suggesting that companies cannot be solely focused on shareholder return, but CEOs must commit to all stakeholders including customers, employees, suppliers, communities, and shareholders. See https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

[13] See https://www.cnbc.com/2020/12/21/sustainable-investing-accounts-for-33percent-of-total-us-assets-under-management.html.

[14] Press releases are not always the best mechanisms to determine precisely what an organization may be doing or reflect the complexity of investment portfolios. Interesting examples include Stanford's explanation of its decision not to divest from fossil fuels in 2016 (https://news.stanford.edu/2016/04/25/stanford-climate-change-statement-board-trustees/) and, more recently, Rockefeller Foundation's announcement of a divestment strategy on fossil fuels that appears, in practice, to be less of a complete divestment but rather to cease investing further in private energy investments, similar to what some foundations have decided (https://www.rockefellerfoundation.org/news/the-rockefeller-foundation-commits-to-divesting-from-fossil-fuels/).

[15] Harvard's Sustainable Investment Policy considers material ESG factors in the course of its investment analysis and how that may impact the performance of its investments. http://www.hmc.harvard.edu/content/uploads/2020/11/HMC-Sustainable-Investment-Policy.pdf. Stanford takes a similar approach. https://smc.stanford.edu/wp-content/uploads/2020/01/SMC-Ethical-Investment-Framework.pdf.

https://news.stanford.edu/2020/06/12/trustees-commit-accelerating-transition-to-net-zero-greenhouse-gas-emissions/.

Differing Claims of Investment Impact and Returns

Another element contributing to heated debate is whether socially responsible investing ("SRI") (the use of screens), impact investing (seeking a double bottom line and not the use of program-related investments), and/or the use of ESG factors will diminish investment returns. Many investment professionals have long argued that restricting an investment universe through eliminating exposure to certain assets by the use of screens or consideration of non-investment-related factors will inevitably mean lower returns under modern portfolio theory. While initial efforts of SRI were largely premised on moral or ethical concerns, arguments have evolved to address concerns about the potential for breaches of fiduciary duty. The debate, like others, is often confused because studies may evaluate different strategies such as screens versus the use of ESG factors, use different benchmarks as comparisons, and occur over different time periods.

Proponents of SRI, impact investing, or ESG investing have historically made two arguments: first, that the societal or impact benefits of using screens or ESG factors to avoid morally or ethically problematic investments more than made up for any potential limit on returns; and second, and more recently, that using ESG factors as part of an investment process would, in fact, lead to equal or better returns. This latter argument has gained more traction over the last ten years as proponents have pointed to a bevy of studies allegedly showing that investing with companies that have high ESG scores outperform other potential strategies.[16] For example, divestment efforts targeting fossil fuel companies initially focused on the moral and ethical issues associated with such investments, including the impact on the environment and the conduct of companies in allegedly denying climate change or misleading the public. Proponents of divestment today are more inclined to also rely on an investment thesis of stranded assets to argue such investments are a bad investment; the argument is that fossil fuel companies are valued, in part, based upon the inventories they may have on hand or in the ground but that valuation is too high because they will never be able to extract the assets because of regulatory concerns, the threat of litigation, and market forces. This type of argument would, therefore, be consistent with fiduciary duties of loyalty and prudence because it is based on an active investment strategy.

The Debate Continues and an Effort to Address the Confusion

Notwithstanding the guidance offered by regulatory agencies and efforts by proponents of ESG investing to provide clarity, there remains confusion in many circles because of the difference in organizations and the understanding of the applicable law.

[16] See variety of studies cited by Schanzenbach/Sitkoff at 395-397, nn.65-75 and Gary at 753-754, nn.82-89.

The Schanzenbach/Sitkoff article offers a useful construct in thinking about how to cut through some of the potential confusion consistent with fiduciary duties. In short, they argue for the following proposition:

They first define ESG investing (a strategy that emphasizes a firm's governance structure or the environmental or social impacts of the firm's products or services). They argue that the "term 'ESG investing' is inherently ambiguous as to whether the investor's purpose is collateral benefits (what they term classic socially responsible investing) or improved risk-adjusted returns (and it is widely and confusingly used today to encompass both") Schanzenbach/Sitkoff at 397.

They, therefore, divide ESG investing into two categories: risk-return ESG investing and collateral-return ESG investing. Risk-return ESG investing is investing using ESG factors because the investor expects to obtain a better risk-adjusted return. Collateral-return ESG investing is investing using ESG factors to address collateral benefits other than to the beneficiary of the trust, such as cleaner air generally or better conditions for workers, etc. The distinction turns on the investor's motive. Id. at 397. They argue that, under relevant trust law, a trustee's use of ESG factors if motivated by the trustee's own sense of ethics or to obtain collateral benefits for third parties violates the duty of loyalty. Id. at 399.

With respect to risk-return ESG investing, the authors suggest that risk-return ESG can be consistent with the duty of loyalty provided that the fiduciary's sole or exclusive motive is benefiting the beneficiary by improved risk-adjusted returns. They further argue that while "there is theory and evidence in support of risk-return ESG … this support is far from uniform, is often contextual, and in all events is subject to change, especially as markets adjust to the growing use of ESG factors." Id. at 454. They assert that "[p]roponents of risk-return ESG have conflated evidence of a relationship between an ESG factor and firm performance with evidence that such a relationship, if any exists, can be **exploited by an investor for profit**." Id. at 390 (emphasis supplied). They conclude that a trustee could undertake a program of ESG investing via active investing, provided that the trustee has a documented, reasonable analysis showing expected return benefits that offset any associated costs, and that the trustee updates this analysis periodically in light of experience with actual costs and returns. Id. at 390-391.

Importantly, for our purposes, they also recognize that a third-party benefit obtained via a charity's investment program that is within the charity's charitable purpose is not a collateral benefit but rather a benefit that falls within the sole interest of the charity's purpose. Id. at 391.

In short, their analysis "challenges both the current zeitgeist in favor of ESG investing by a trustee and the common knee-jerk reactions that ESG investing necessarily violates the duty of loyalty." Id. at 386.

It is important to note that other observers/commentators take a different view. See Gary at 733. Professor Gary[17] argues that shifts in investment practices and underlying duties to beneficiaries both now and in the future require trustees to consider ESG factors. It is also worth emphasizing that

[17] Professor Gary is a well-respected commentator on issues of fiduciary duty. The article was developed with financial assistance from Rockefeller Foundation.

companies that have strong ESG practices that might make them attractive investments will inevitably result in having a beneficial impact outside of their share price.

What this means for a private foundation

A private foundation subject to the jeopardizing investment rules of section 4944 and UPMIFA must consider a range of factors in making its investment decisions to meet its fiduciary duties as set forth in Exhibit A, including the relationship of an investment asset to the foundation's charitable purposes. Defining what the foundation means by its charitable purposes is an important step in this analysis so that it can have a workable framework to assess our choices. It is also important that the way the foundation talks and communicates about its decisions should be rooted in the context of the relevant duties and law, a point that is sometimes lost for other organizations or commentators in the passion for the desired end result.

A foundation constituted as a perpetual foundation for charitable purposes does provide some boundaries and requires a board to consider carefully the balance between immediate needs and the needs of future generations.

Consequently, the following are suggested steps and practices as a foundation considers its alternatives:

- The board should identify clearly (i) the objectives for the investment portfolio, (ii) the rationale underlying the objectives and how that links to accomplishment of our mission and our status as a perpetual foundation, (iii) the philosophy and tools to be used, and (iv) why any changes from the current approach are appropriate and needed.

- In determining any changes to our approach, the board should carefully assess a range of alternatives and their impact and articulate clearly the reasons for the decisions (this can be captured in a revised policy or in board minutes).

- The board should assess our investment decisions – and document changes – in light of expected returns and risks. When possible, the board should have support for the proposition that the investment changes will not limit returns, and may enhance returns.

- In those cases, where there is not solid support that changes will enhance returns, a board should articulate how the investments further the foundation's charitable mission as reflected principally in programmatic strategies and why any potential diminishment in financial returns is justified.

- The board[18] should monitor performance of the investment portfolio and make appropriate changes based on performance and changing circumstances.

[18] A board can exercise its responsibilities through an investment committee as long as it provides periodic oversight.

- In public statements and explanations, the foundation should be clear for the reasons for its approach (being clear, for example, that it is not compromising returns or are willing to sacrifice returns for desired programmatic impact, or some combination thereof). While using the phrase "alignment with our values" to explain investment decisions may be shorthand for a programmatic rationale, such language fits less neatly into the legal and fiduciary framework and might be buttressed with additional language relating to the foundation's charitable mission.

EXHIBIT A

Uniform Prudent Management of Institutional Funds Act (UPMIFA)

Section 760 ILCS 51/3 - Standard of Conduct in Managing and Investing Institutional Fund

(a) Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purposes of the institutional fund.

(b) In addition to complying with the duty of loyalty imposed by law other than this Act, each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

(c) In managing and investing an institutional fund, an institution: (1) may incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution; and (2) shall make a reasonable effort to verify facts relevant to the management and investment of the fund.

(d) An institution may pool two or more institutional funds for purposes of management and investment.

(e) Except as otherwise provided by a gift instrument, the following rules apply:

(1) In managing and investing an institutional fund, the following factors, if relevant, must be considered:

- **(A) general economic conditions;**
- **(B) the possible effect of inflation or deflation;**
- **(C) the expected tax consequences, if any, of investment decisions or strategies;**
- **(D) the role that each investment or course of action plays within the overall investment portfolio of the fund;**
- **(E) the expected total return from income and the appreciation of investments;**
- **(F) other resources of the institution;**
- **(G) the needs of the institution and the fund to make distributions and to preserve capital; and**
- **(H) an asset's special relationship or special value, if any, to the charitable purposes of the institution.**

(2) Management and investment decisions about an individual asset must be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution.

(3) Except as otherwise provided by law other than this Act, an institution may invest in any kind of property or type of investment consistent with this Section.

(4) An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification.

(5) Within a reasonable time after receiving property, an institution shall make and carry out decisions concerning the retention or disposition of the property or to rebalance a portfolio, in order to bring the institutional fund into compliance with the purposes, terms, and distribution requirements of the institution as necessary to meet other circumstances of the institution and the requirements of this Act.

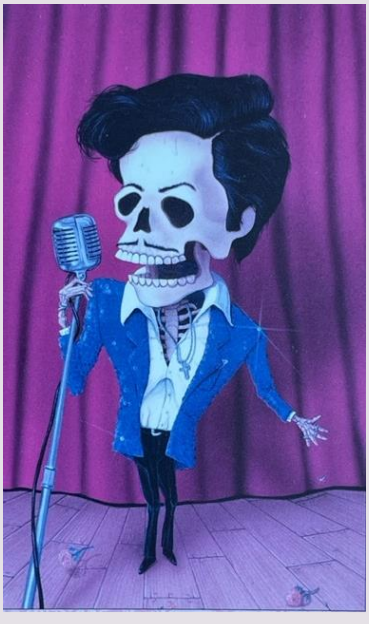
(6) A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds.

(Source: P.A. 96-29, eff. 6-30-09.)

Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Pomar Foundation

How Can Founders Be Assured of Adherence to Mission

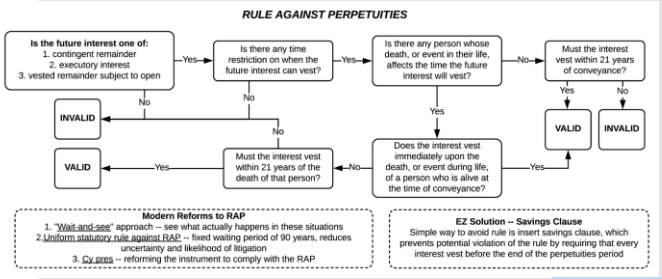
Ofer Lion

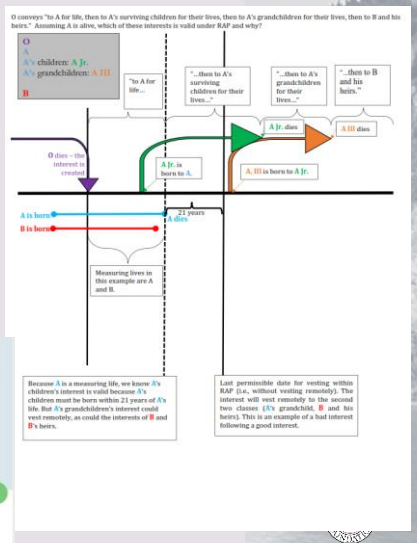


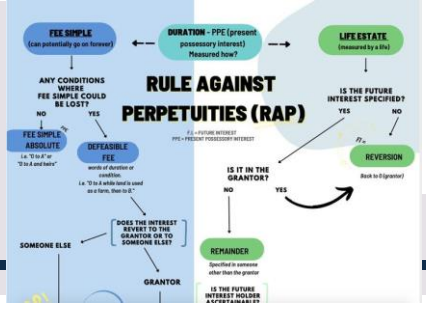
Option One: Let's Not Avoid the Obvious

- Live forever

Dead Hand Control vs. Rule Against Perpetuities







Rocky Mountain Tax Seminar
for Private Foundations
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Dead Hand Control vs. Rule Against Perpetuities

- No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.

  — John Chipman Gray, Rule Against Perpetuities § 201 (1886)

- The rule against perpetuities generally prevents too much "dead hand control" over private property.

- Property held by nonprofit corporations and charitable trusts, which are typically perpetual from a legal entity perspective, is deemed held in charitable trust for the public, making the RAP inapplicable

- So, you future directors and trustees must adhere to my charitable mission… Forever!!!

Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Ponar Foundation

What's the Problem?

- Runaway Boards
- Greedy executives
- Too much / not enough money
- Mission becomes impossible, impracticable (or so they say)
- Mission isn't clear/too broadly defined
- Change in purpose
- Mission drift
- Philadelphians

Perpetual Control – Enforcement of Trusts / Restricted Gifts

- A clear and detailed statement of mission – a letter to the future directors and trustees
- Supermajority / unanimity required
- Third-party enforcement rights after the Barnes case – not just the AG
- Change in mission (or changes to Articles or Bylaws which would diminish this protection) to require the unanimous written consent of the board of the following five nonprofits, and the written consent of the Chancellors of the following five universities.
- Shark repellent
- If the art must be moved, it must go to Pittsburgh
- If the mission must change, so does the [trustee, CEO/President/Executive Director]

Perpetual Control – Enforcement of Trusts / Restricted Gifts

- But… a little flexibility is a good thing.

"A foolish consistency is the hobgoblin of little minds, adored by little statesmen and philosophers and divines."

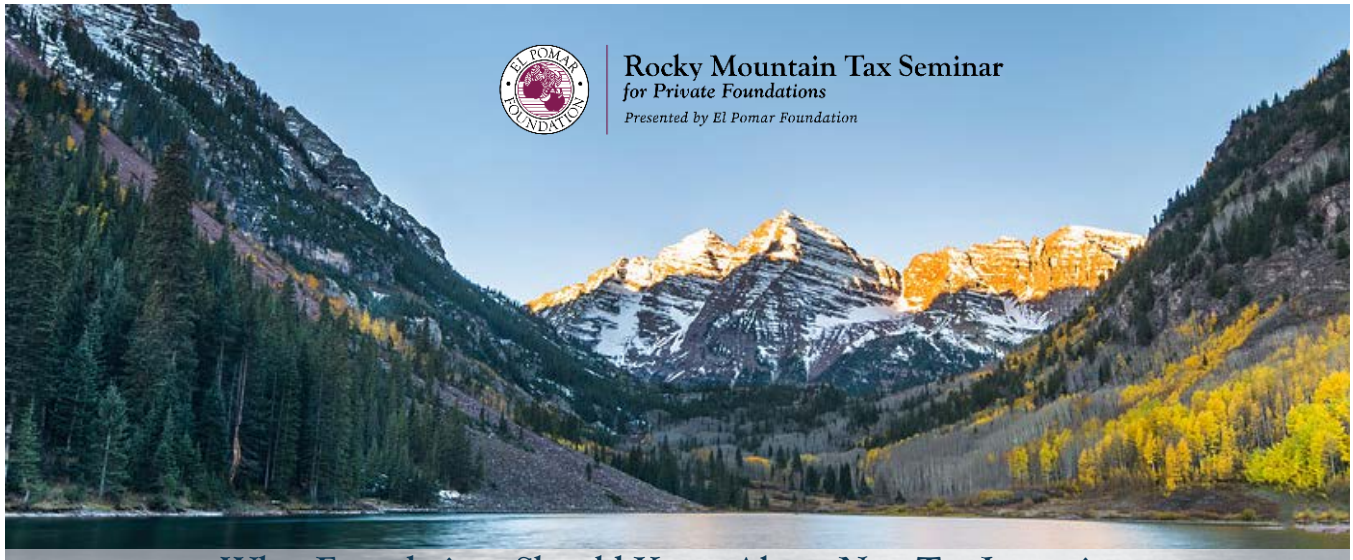
Thank You

Ofer Lion
Seyfarth Shaw LLP
Los Angeles

Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Pomar Foundation

How Can Founders Be Assured of Adherence to Mission

Ofer Lion



What Foundations Should Know About New Tax Incentives

GLAM, TEOS & EO BMF Extract:

How Treasury & IRS Communicate about EO Laws & EOs

Ruth Madrigal, KPMG LLP
September 15, 2023

Energy Tax Credits Overview

Prior law

- Under prior law there were energy investment and production tax credits, though many were expired or phasing down.
- Credits included:
  - Sec. 30C – Alternative fuel vehicle refueling property credit
  - Sec. 45 – Electricity produced from certain renewable resources
  - Sec. 45Q – Credit for carbon oxide sequestration
  - Sec. 48 –Investment tax credit - energy credit (part of sec. 38 general business credit)
  - Sec. 48C – Qualifying advanced energy project credit
- All credits were nonrefundable and nontransferable

ENERGY TAX CREDITS OVERVIEW

Prior law (cont.)

- Tax-exempt and government entities had very limited ability to utilize the investment tax credits –
  - Under **section 50(b)(3)**, tax-exempt organizations could not claim a credit unless the applicable property was **used predominantly in an unrelated trade or business**;
  - Under **section 50(b)(4)(A)(i)**, property used "by the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing" was ineligible for the credit altogether.
  - Under many individual credit provisions, **credit property must be business property** to qualify for the credit (i.e., property "of a character subject to an allowance of depreciation" or property "for which depreciation… is allowable")

ENERGY TAX CREDITS OVERVIEW

The Inflation Reduction Act made significant changes to energy tax credits

- Significant enhancements and modifications were made to existing energy tax credits for solar, wind, EVs, charging stations, etc.
- New credits were added for additional technologies and activities
- For many credits, new prevailing wage and apprenticeship requirements must be met to receive highest available credit amounts
- Additional "bonus" credit rates are possible - depending, *inter alia*, on where the property is placed in service and domestic content requirements
- **New "direct pay" election allows tax-exempt and government entities ("applicable entities") to access credits by making them "refundable"**
- Transferability election allows other taxpayers (*i.e.*, those who are not applicable entities) to more easily monetize credits

Direct Pay Overview

SECTION 6417 – DIRECT PAY ELECTION

- **Tax-exempt and governmental entities can make a "direct pay" election and receive a cash refund for the amount of several specified credits in excess of their tax liability.**
- **The statute includes provisions designed to "turn off" the limitations in the pre-existing law that kept tax-exempt and government entities from participating in the tax incentive.**
- **Effective for tax years beginning after December 31, 2022.**

SECTION 6417 - DIRECT PAY ELECTION

(a) In general

In the case of an **applicable entity** making an **election** (at such time and in such manner as the Secretary may provide) under this section with respect to any **applicable credit** determined with respect to such entity, such entity shall be treated as making a **payment against the tax** imposed by subtitle A (for the taxable year with respect to which such credit was determined) **equal to the amount of such credit**.

- *If the deemed "payment" exceeds the entity's tax liability, it will receive a cash refund for the difference between the credit amount and its tax liability.*

SECTION 6417 - DIRECT PAY ELECTION (CONT.)

(d)(2) Application

In the case of any applicable entity which makes the election described in subsection (a), any applicable credit shall be determined—

(A) without regard to paragraphs (3) and (4)(A)(i) of section 50(b), and

(B) by treating any property with respect to which such credit is determined as used in a trade or business of the applicable entity.

- *Clearly, this is aimed at eliminating the technical statutory barriers that kept tax-exempt and government entities from accessing the credits in the past and is a strong indication that Congress intended tax exempt and government entities to benefit from these incentives.*

DIRECT PAY ELECTION

"Direct pay… [is] central to achieving our economic and climate goals. [It] will … enable communities … and nonprofits to access the credits… and more communities will benefit. The IRA allows nonprofit and governmental entities to receive direct payments for 12 clean energy tax credits, including the major investment and production tax credits."

-- Lily Batchelder, Assistant Secretary for Tax Policy*

* Remarks by Assistant Secretary for Tax Policy Lily Batchelder on Implementation of the Inflation Reduction Act's Clean Energy Provisions, March 22, 2023

SECTION 6417 - DIRECT PAY ELECTION – PROPOSED REGULATIONS

Proposed regulations under section 6417, relating to the direct pay election, and under section 6418, relating to transferability, were published in the Federal Register on June 21, 2023. The section 6417 proposed regulations can be found at https://www.govinfo.gov/content/pkg/FR-2023-06-21/pdf/2023-12798.pdf

At the same time, temporary regulations relating to the pre-filing registration requirements for both section 6417 and section 6418 were also published in the Federal Register. They can be found at https://www.govinfo.gov/content/pkg/FR-2023-06-21/pdf/2023-12797.pdf

DIRECT PAY ELECTION MECHANICS

Applicable entity must make the direct pay election to access credit

- Election must be made on an original annual tax return, no later than the due date (including extensions), with additional required forms

The Secretary may require information or registration deemed necessary to prevent **duplication, fraud, improper/excessive payments**

- Online pre-filing registration is required

Penalty for "excessive payments" = 120% of the "excessive payment" (or just the excessive payment amount if reasonable cause is demonstrated)

TRANSFERABILITY OF CREDITS – SECTION 6418

- "Eligible taxpayer" – **any taxpayer which is not an "applicable entity"** described in section 6417(d)(1)(A) (referring generally to tax exempt and government entities) – can elect to transfer all or a portion of several specified credits to an unrelated "transferee taxpayer" and receive cash in return; credits cannot be transferred more than once.
- Amounts received in cash are not included in gross income of the eligible taxpayer (and amounts paid by the transferee taxpayer are not deductible)
- Eligible credits are same as 6417 except that the credit under section 45W (relating to qualified commercial vehicles) is not included
- Penalty applies for excessive credit transfer, unless there is reasonable cause

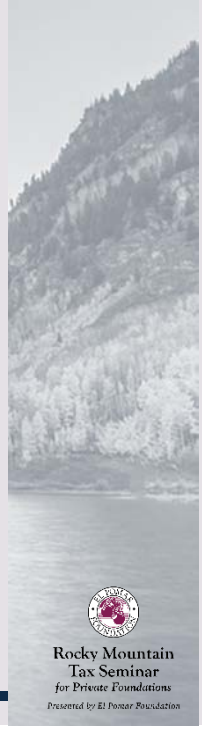
Direct Pay - Details

DIRECT PAY ELECTION – APPLICABLE ENTITIES

The statute states that organizations eligible for direct pay ("applicable entities") include:

- Any organization exempt from the Federal income tax imposed by subtitle A of the Code (*e.g.*, 501(c) organizations)
- Any state or political subdivision thereof
- The Tennessee Valley Authority
- An Indian tribal government
- Any Alaska Native Corporation
- A rural electric cooperative

(Note that other taxpayers are eligible for direct pay for certain credits)



DIRECT PAY ELECTION – APPLICABLE ENTITIES (CONT.)

Proposed regulations clarify that the term "applicable entity" includes a variety of tax-exempt and governmental entities not expressly mentioned in the statute, including:

- Governments of U.S. territories and their political subdivisions
- Tax-exempt entities in U.S. territories
- District of Columbia
- Subdivisions of Indian tribal governments
- **Agencies and instrumentalities of any state, the District of Columbia, Indian tribal government, U.S. territory or political subdivisions of any of the foregoing**

DIRECT PAY ELECTION – APPLICABLE ENTITIES (CONT.)

Proposed regulations also address situations where a disregarded entity or a partnership directly holds the applicable credit property:

- Disregarded entities are disregarded – their activities are attributed to their owner and if the owner is an applicable entity, it could elect direct pay for the credit
- Partnerships are NOT applicable entities
  - Even if all of the partners are applicable entities, the partnership is not
  - Some commentors have asked that partnerships with all EO partners be considered applicable entities (*e.g.*, AICPA comment letter dated Aug. 14, 2023)

APPLICABLE CREDITS

Pre-IRA credits (now with a direct pay option):

Sec. 30C – Alternative fuel vehicle refueling property credit

Sec. 45 – Electricity produced from certain renewable resources (but only for projects originally placed in service after 12/31/2022)*

Sec. 45Q – Credit for carbon oxide sequestration (but only for projects originally placed in service after 12/31/2022)

Sec. 48 – Energy credit*

Sec. 48C – Qualifying advanced energy project credit

* Special phaseout rule for direct pay if domestic content requirements aren't satisfied.

SECTION 48 ENERGY CREDIT

Approximately 16 types of property qualify under section 48, including:

Solar energy property

Combined heat and power system property (cogen)

Geothermal heat pumps

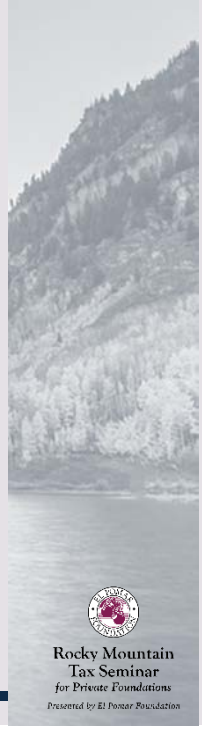
Energy storage technology

Thermal energy storage property

Fuel cell powerplants

Microturbine powerplants

Microgrid controller



APPLICABLE CREDITS (CONT.)

New Credits (with a direct pay option):

Sec. 45U – Zero-emission nuclear power production credit

Sec. 45V – Credit for production of clean hydrogen (but only for projects originally placed in service after 12/31/2022)

Sec. 45W – Credit for qualified commercial clean vehicles

Sec. 45X – Advanced manufacturing production credit

Sec. 45Y – Clean electricity production credit*

Sec. 45Z – Clean fuel production credit

Sec. 48E – Clean electricity investment credit* (technology neutral)

* Special phaseout rule for direct pay if domestic content requirements aren't satisfied.

SECTION 48E (NEW) ENERGY CREDIT

–Section 48E is available for property that is **placed in service after 2024**

Facility must be a "zero emissions" facility (except for energy storage technology and thermal energy storage property)

- Certain technologies that qualify under section 48 would likely not qualify under new section 48E without carbon capture (*i.e.*, cogen, fuel cells, microturbines)
- Solar energy property would likely qualify as zero emissions
- Credit phases down to 0% after 2025 unless domestic content requirement met

Phases out over a three-year period beginning the later of: (i) projects that begin construction after 2032 or (ii) when electric power sector's carbon emissions are reduced by 75% as compared to 2022 levels

OVERVIEW OF § 48 INVESTMENT TAX CREDIT (ITC)

One-time investment tax credit (ITC) equal to a percentage of the eligible basis of qualifying energy property placed in service during the taxable year.

Eligible basis* ✖ **ITC %** = **ITC**

Eligible Basis

- Compute eligible basis based on project costs
- Cost segregation analysis identifies eligible vs. ineligible direct costs
- Generally indirect costs allocated based on direct costs

ITC %

- Base rate
- Prevailing wage & apprenticeship bonus
- Domestic content bonus (or reduction)
- Energy community bonus
- Environmental justice bonus

Published Guidance

Credit Rate “Bonuses”

BONUS" CREDIT RATES

Prevailing wage & apprenticeship requirements

- "Bonus rates" are available for projects which satisfy certain wage and apprenticeship requirements during construction and operation of the projects – bonus is generally 5 times the "base rate" (i.e., 30% vs 6% base)
- Meeting prevailing wage and apprenticeship requirements can also be key to getting other top bonus credit rates

"BONUS" CREDIT RATES (CONT.)

Domestic content

- For several credits, additional up to 10% credit rate may be available if projects are constructed using specified levels of domestically sourced steel, iron, and manufactured products
- For direct pay, main investment and production tax credits **phase out after 2025** if domestic content requirements are *not* met (for projects over 1 megawatt)
  - Secretary may provide exception if there is insufficient supply or cost would be more than 25% higher

"BONUS" CREDIT RATES (CONT.)

Other targeted credit enhancements

- Additional credit rates available in some cases for energy projects located in "energy communities" – including brownfields and communities formerly reliant on coal and fossil fuel industries – and in certain low-income communities or projects
  - Up to 10% for energy community
  - Up to 20% for environmental justice allocation

OTHER CREDIT AMOUNT ADJUSTMENTS

- Underlying credit provisions (e.g., § 48) may provide that credit amount is reduced if tax-exempt bond financing is used
  - For example, the section 48 investment tax credit may be reduced up to 15% if the property is tax-exempt bond financed

- Direct pay proposed regulations also would reduce credit amount if property is acquired with income (including grants and forgivable loans) that is exempt from tax and received "for the specific purpose" of acquiring certain "investment-related credit property" (i.e., credit property for §§ 30C, 45W, 48, 48C, 48E)

Published Guidance

Thoughts for Funders

WHEN IS A PRI USEFUL ?

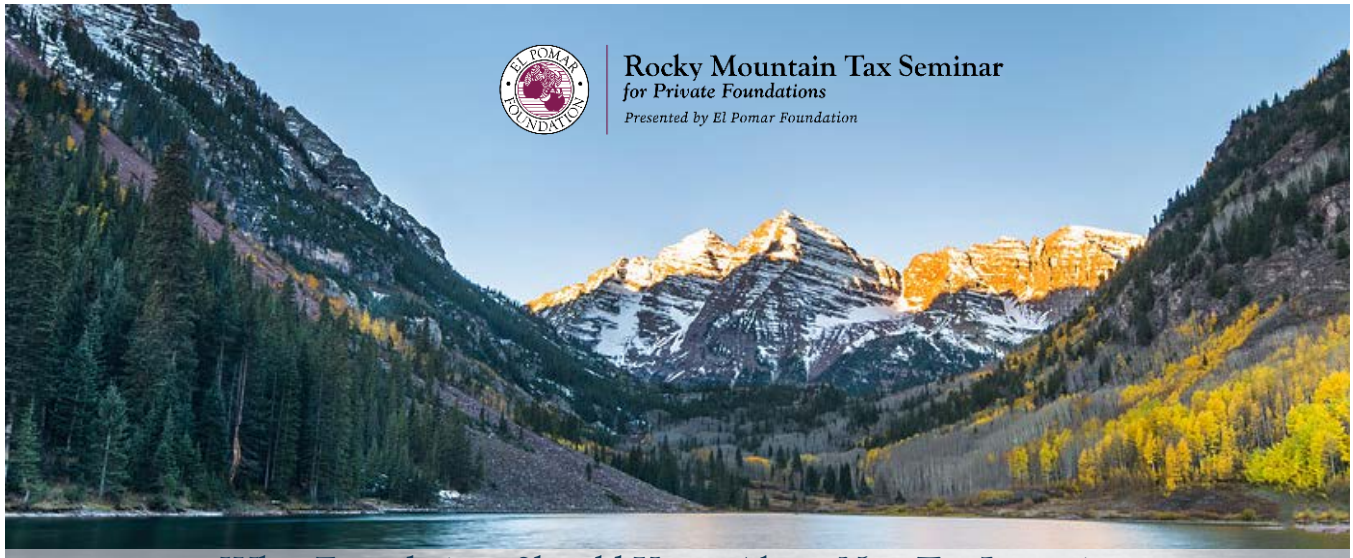
- When a charity needs temporary capital (vs permanent capital) or can use the funding to generate additional income or reduce funded expenses
- When for-profit entities are performing (or can be incentivized to perform) activities that can accomplish charitable purposes
- When charitable capital can “pull” non-charitable capital in a charitable direction
- Are there PRI opportunities related to new incentives to invest in clean energy property?

PRI OPPORTUNITIES?

- Although the new credits are more generous and are newly available to tax exempt organizations, lack of information, complexity and limited access to capital are likely barriers to access the credits.
- Low-income taxpayers also have barriers to access the new credits and may have limited ability to utilize or transfer credits
- Low-income and marginalized persons may not have access to job opportunities created in connection with prevailing wage and apprenticeship rules
- Query whether PRIs may help bridge the gaps?

SOME CONSIDERATIONS TO KEEP IN MIND

- Limits on credits for section 30C, 45W, 48, 48C, 48E ("investment-related credit property") when property is acquired with "Restricted Tax Exempt Amounts"
  - Cash flow
  - Interactions with grant rules/provisions and structuring considerations
- Opportunities for other funding
  - Bonus credit amounts?
  - Transferability?
  - Grant funding – federal, state, private?
- Direct pay only for credits determined with respect to the applicable entity
  - Can't buy credits and then elect direct pay for purchased credits
  - But can buy credits to use to pay UBIT liability



Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Pomar Foundation

What Foundations Should Know About New Tax Incentives

GLAM, TEOS & EO BMF Extract:

How Treasury & IRS Communicate about EO Laws & EOs

Ruth Madrigal, KPMG LLP

September 15, 2023

Governance Principles and Practices for Private Foundations

Maureen Lawrence and Ann Batlle

OVERVIEW

I. Part One – Good Governance: Principles & Practices

A. Sources of Director Duties
B. Key Board and Board Committee Responsibilities
C. Board and Board Committee Effectiveness Tools

II. Part Two – Conducting a Governance Review

A. When to Conduct a Governance Review
B. Key Components of a Governance Review
C. Case Example – El Pomar Foundation's Governance Review Project

Sources of Director Duties

- State Law
  - Fiduciary Duties
    - Duty of Care
    - Duty of Loyalty
    - Duty of Obedience to Mission
  - Business Judgment Rule
- Governing Documents
  - Articles of Incorporation
  - Bylaws

Sources of Director Duties, Cont'd

- Board Policies & Procedures
  - Board Committee Charters
  - Corporate Governance Guidelines
  - Code of Ethics
  - Conflict Policy & Annual Disclosure Forms
  - Whistleblower Policy
  - Document Retention Policy
  - Compensation Philosophies: Executive & Board

Key Board & Board Committee Responsibilities

- Audit
- Risk Management
- Compensation
- Governance
- Climate and Culture
- Investment

Board & Board Committee Effectiveness Tools

- Board Orientation+
- Board and Board Committee Self-Assessments*
- Periodic Board Training
- Executive Sessions
- Best Practices in Board & Board Committee Minutes

See sample orientation agenda at: https://boardsource.org/nonprofit-board-orientation-checklist/

* See link to a sample assessment tool at: https://boardsource.org/board-support/assessing-performance/board-self-assessment/tools-foundations-schools-associations-credit-unions/

Part Two: Conducting a Governance Review

When might an organization engage in a formal governance review?

- When leadership changes
- When building succession plans
- In response to specific issues or circumstances warranting a review

Conducting a Governance Review, Cont'd

Key Components of a Governance Review:

- Identify the purpose, scope, and key objectives
- Identify who is involved
- Conduct review activities
- Summarize findings & recommendations
- Implementation

Case Example: El Pomar Foundation's Board Governance Review Project

Case Example: El Pomar Foundation's Board Governance Review Project

- **Stage 1: Scope and Key Objectives**
  - Timeline – up to 18 months
  - Three main objectives:
    - Address succession planning
    - Review existing board structures and processes
    - Engage in documentation project to honor, preserve and articulate the intention of El Pomar's donors

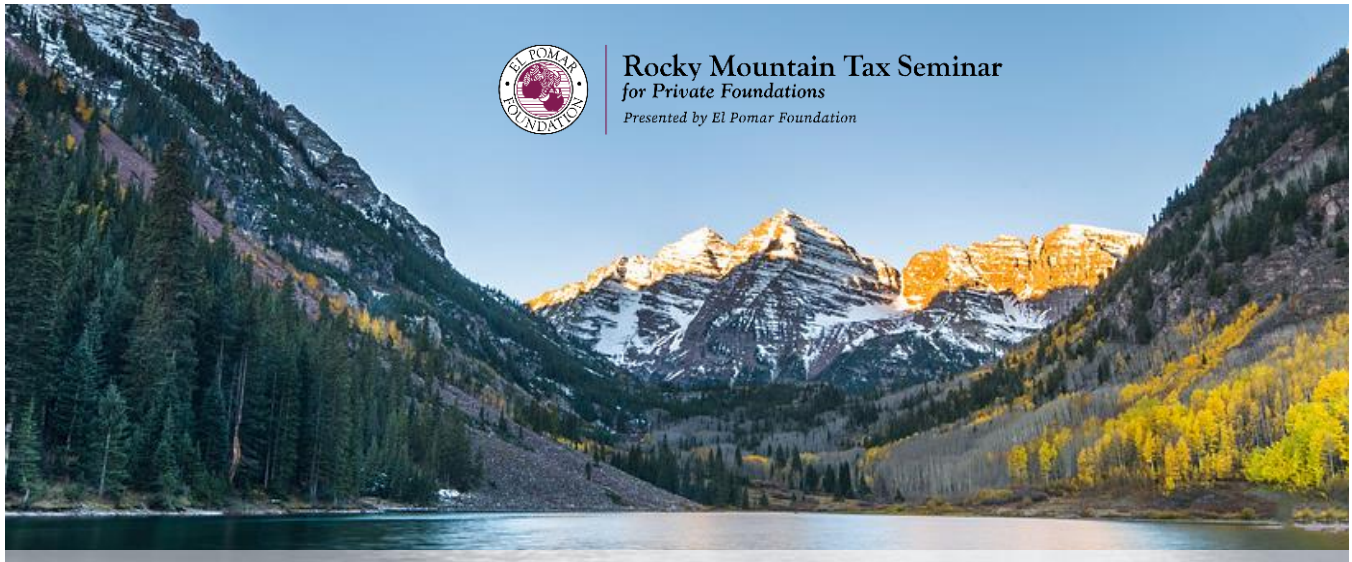
Case Example: El Pomar Foundation's Board Governance Review Project, Cont'd

- **Stage 2: Information Gathering**
  - One-on-one interviews
  - Research
- **Stage 3: Analysis and Recommendation Phase**
  - Formal report of recommendations
  - Board approval
- **Stage 4: Implementation**

Case Example: El Pomar Foundation's Board Governance Review Project, Cont'd

General Reflections on Project:

- Board commitment and engagement is critical
- Close coordination between CEO & Board is essential
- Governance is an ongoing project



Governance Principles and Practices for Private Foundations

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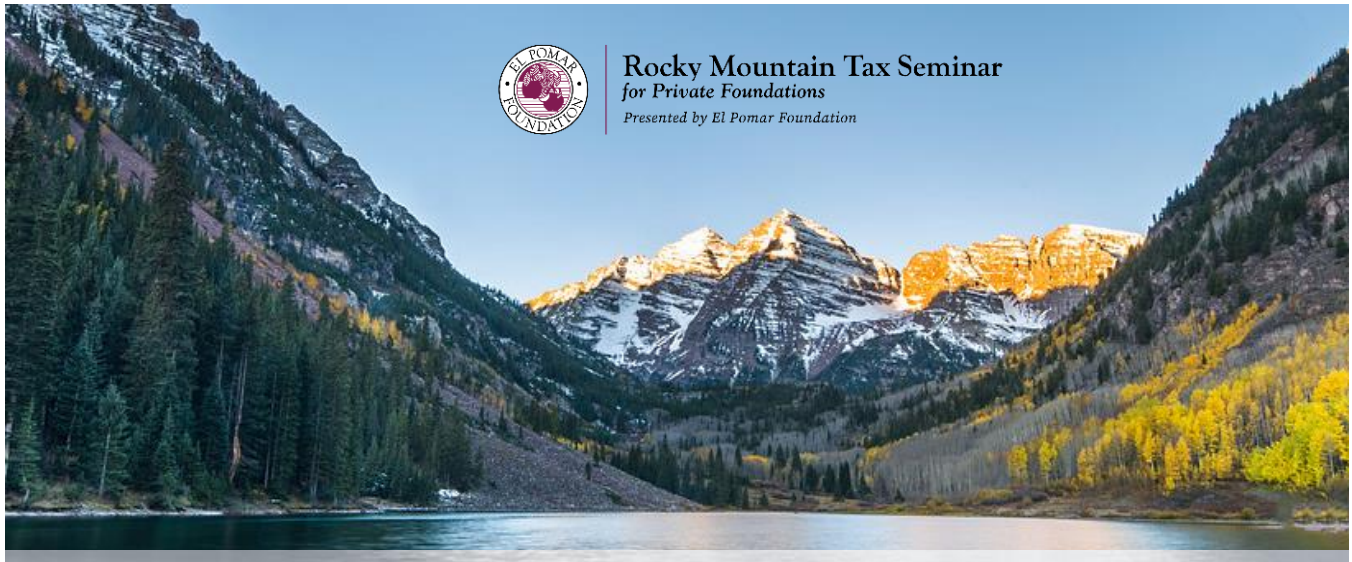


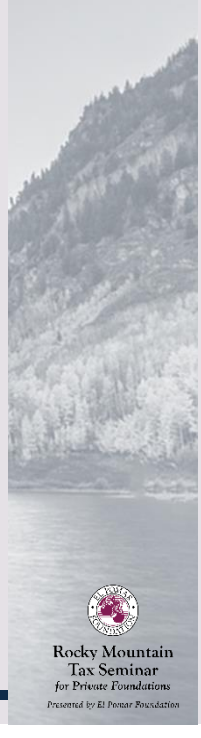
Preparing Foundations for IRS and AG Investigations

Ofer Lion and Ruth Madrigal

Notice

The following information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.



AGENDA

- IRS Examinations
- Self-Dealing and Conflicts of Interest
- State AG Investigations (Fraud/Embezzlement example)
    - A Dozen Things to Deal With
        - Reporting
        - The Attorney General
        - Prevention

IRS EXAMINATIONS

Preparing For An IRS Examination

1. Know the potential issues
2. Know your organization and identify your [highest risk] issues
3. Bolster documentation and/or make corrections before the IRS arrives

Know The Potential Issues

What does the IRS care about? Collecting taxes!

- Income taxes – if organization isn't operated for exempt purposes
  - Donor income taxes - if not a charity or not an operating/conduit foundation
- Unrelated Business Income Tax
- Section 4940 Net Investment Income Tax
- Other Chapter 42 Excise Taxes
  - Self-dealing, jeopardizing investments, insufficient qualifying distributions, taxable expenditures
- Employment taxes
- Section 4960 Excise Tax on Exempt Employee Compensation

Know the Potential Issues (Cont.)

Some specific areas of concern relating to private foundations

- Private benefit/private inurement/self-dealing
  - Foundation loans to DPs
- Non-compliance by wealthy individuals using of private foundations (and other exempt organizations)
- Employment taxes
- Co-investments between foundations and disqualified persons
- Avoidance of foundation distribution requirements with grants to DAFs

Where to find clues to the issues the IRS may ask about

- TE/GE Accomplishments Letter – Pub. 5329 (issued in ~ December)
- Treasury/ IRS Priority Guidance Plan (issued in late summer/fall)
- Treasury's Budget Proposals (issued in ~ February)
- Recently enacted provisions – once final regulations are issued
  - UBIT Silo'ing and Section 4960
- IRS Technical Guides / Audit Technique Guides and Issue Snapshots

FY22 TE/GE Accomplishments Letter Pub. 5329 (Rev 12-2022)

Tax Exempt & Government Entities

Edward T. Killen
Commissioner, TE/GE

Robert S. Choi
Deputy Commissioner, TE/GE

Message from the Tax Exempt and Government Entities (TE/GE) Commissioners

Greetings,

Fiscal year 2022 was a year of transition for TE/GE. We successfully adapted to changing circumstances and overcame unprecedented challenges. We resumed normal operations and returned to IRS offices (in the third and fourth quarters) after more than two years of teleworking due to the COVID-19 pandemic. We said farewell to TE/GE's longtime Commissioner Sunita Lough when she retired on September 30 and we welcomed a new leadership team.

We continued to provide the tax-exempt sector with top-notch service while promoting voluntary compliance. We remained firmly committed to our mission and strategic goals and objectives — strengthening compliance, maintaining a taxpayer focused organization, hiring and training, collaborating with external and internal partners, improving processes, and enhancing data analytics and processing.

Every TE/GE employee played a role in the organization's success and significant achievements. Here's a quick snapshot of some highlights:

- Continued to strengthen our compliance strategies and enforcement efforts through collaborations with Criminal Investigation (CI), Large Business and International (LB&I), Small Business/Self-Employed (SB/SE), Wage and Investment (W&I), and Research, Applied Analytics & Statistics (RAAS) to identify potential noncompliance in the exempt sector. And we partnered with Information Technology (IT) on modernization efforts.
- Introduced a new Employee Plans (EP) pre-exam compliance program pilot designed to reduce taxpayer burden by allowing plan sponsors to self-correct

Edward T. Killen
Commissioner, TE/GE

FY22 TE/GE Accomplishments Letter

Exempt Organizations

Examinations

	Started	Closed	Change %	Pick-up %
Compliance Strategies	207	475	85.9%	43.4%
Data-Driven	711	938	84.4%	47.8%
Referrals, Claims and Other Casework	2,091	2,012	72.8%	28.6%
Totals	**3,009**	**3,425**	**77.5%**	**35.3%**

EO completed examinations of 3,425 filings in fiscal year 2022, including the Form 990 series (990, 990-EZ, 990-PF, 990-N, 990-T) and their associated employment and excise tax returns. Overall, 78% of closed examinations resulted in a tax change (change percentage) and 35% of the examinations were "picked-up" from a related examination (pick-up percentage). We proposed revocations for 53 tax-exempt entities because of these examinations.

Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Ponar Foundation

FY22 TEGE Accomplishments Letter Pub. 5329 (Rev 12-2022)

Referrals, Claims and Other Casework included:

- "The most prominent issues found in EO's referrals, claims and other casework involve temporary workstreams pertaining to **IRC Section 512(a)(7) (qualified transportation fringes) repeal and COVID-19-related employee retention credit claims**. In terms of regular work, the most prominent issues found relate to **employment taxes, filing requirements, and operating requirements**."

Data-driven Examinations included:

- "…indicators of private benefit/inurement involving officer business partnerships, under-reported credit card income, and related employees and for-profit partnerships. The most prominent issues found in these EO data-driven examinations relate to miscellaneous unrelated business income."

FY22 TE/GE Accomplishments Letter

Compliance Strategies included:

- "Private benefit and inurement: Focused on organizations that show indicators of potential private benefit or inurement to individuals or private entities **through private foundation loans to disqualified persons**."
- "The most prominent issues found in closed compliance strategy examinations relate to **employment taxes, operational requirements, and self-dealing**."

Collaborative Partnerships included:

- "In fiscal year 2022, TE/GE continued to partner with LB&I and RAAS around **high income/high wealth taxpayers and the identification of linkages involving TE/GE organizations**. Collaboration in this area continued with finalizing the development and implementation of a joint exam deskguide and **launched joint exams between IRS divisions**. We expect the joint examinations to continue in fiscal year 2023."

Audit Technique Guides / Technical Guides

- Provide agents with techniques and methods and technical information (law) to help IRS agents work cases involving specific types of exempt organizations.
- TEGE has been combining multiple documents into comprehensive sources of information on various topics. **In FY 2022-23, at least eight Technical Guides covering private foundation topics were issued, including one on each of the Chapter 42 excise taxes.** Each provides instructions to IRS agents for conducting examinations, as well as audit tips/issue indicators.
- Audit Technique and Technical Guides may be found at: https://www.irs.gov/charities-non-profits/audit-technique-guides-atgs-and-technical-guides-tgs-for-exempt-organizations

IRS Issue Snapshots

Issue snapshots are "employee job aids that provide analysis and resources for a given technical tax issue. They are developed through internal collaboration and may evolve as the compliance environment changes and new insights and experiences are contributed."

- 06/28/2022 — Private Foundations: Incidental and Tenuous Exception to Self-Dealing Under Treas. Reg. 53.4941(d)-2(f)(2)
- 03/21/2022 — Private Foundations: Estate Administration Exception to Indirect Self-Dealing Under Treas. Reg. 53.4941(d)-1(b)(3)
- 01/03/2022 — Private Foundations: Treatment of Qualifying Distributions IRC 4942(h)
- 10/07/2021 — Private Foundations: Private Pass-Through (Conduit) Foundations under IRC Section 170(b)(1)(F)(ii)

Listing of all Exempt Organizations Issue Snapshots available online at https://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots

2022-23 Priority Guidance Plan
Fourth Quarter Update (Aug. 21, 2023)

Guidance revising Rev. Proc. 80-27 regarding group exemption letters.

2. Final regulations on §509(a)(3) supporting organizations.

3. Regulations under §512 regarding the allocation of expenses in computing unrelated business taxable income ….

4. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

5 - 8. Regulations under §4966, 4967, and 4958 regarding donor advised funds (and supporting organizations for 4958), including excise taxes on sponsoring organizations and fund management; donors, donor advisors, and related persons; and guidance regarding the public-support computation with respect to distributions from donor advised funds.

9. Regulations under §6104(c). PUBLISHED 08/16/22 in FR as TD 9964 (FILED on 08/15/22).

10. Regulations designating an appropriate high-level Treasury official under §7611.

Know Your Organization (What are your high risk areas?)

- What is your organization's charitable purpose and activities?
  - What did you tell the IRS on your exemption application (Form 1023)?
  - What does your website say?
- Who are your disqualified persons (DPs)?
- Do you have any transactions with DPs or other risks for self-dealing?
- Do you have other excise tax risks?
  - Net investment income tax
  - Distributions (annual 5% requirement, charitable purposes, non-PC grantees)
  - Excess business holdings
  - Jeopardizing investments
- Do you have a living HNWI donor?

Know Your Organization (cont.)

- Who are your employees? Do you have independent contractors? Do you have volunteers or "donated labor"?
  - Do you have any employment tax risks?
- Who are your "covered employees"?
  - Do you (or a related entity) have a risk of Section 4960 Tax on Employee Compensation?
- Are your NII and UBIT tax calculations correct?

Correct errors before the IRS arrives

- Correction of prohibited transactions/activities
- Consider Filing Form 4720
- Consider requesting abatement due to reasonable cause, not willful neglect
- Consider voluntary disclosure to IRS
- Consider disclosure to other stakeholders

Abatement of Foundation Excise Taxes

N. Abatement of Excise Taxes

(1) Under Sections 4961 and 4962, abatement is available for the following taxes:

Code Section	First Tier	Second Tier
4941	No	Yes
4942	Yes	Yes
4943	Yes	Yes
4944	Yes	Yes
4945	Yes	Yes

(2) To qualify for abatement of second tier tax, the taxable event must be corrected within the correction period. See Section 4961(a). The taxpayer qualifies for abatement of first tier tax if the taxpayer establishes to the IRS' satisfaction that the taxable event:

a. Was due to reasonable cause,

b. Wasn't due to willful neglect, and

c. Was corrected within the correction period. Section 4962(a).

Abatement of Foundation Excise Taxes (cont.)

Exempt Organizations Technical Guide *TG 58 Excise Taxes on Self-Dealing under IRC 4941* notes (at page 77):

"If the taxpayer requests abatement during the examination, verify correction first. If the facts don't warrant abatement, document the willful neglect and failure to establish reasonable cause. **If the facts warrant abatement, don't propose the tax.** Address the issue in an advisory closing letter." (emphasis added)

Available at https://www.irs.gov/pub/irs-pdf/p5616.pdf (visited 08.27.23)

Examples of Possible Abatement*

- Example: The foundation incurred a Section 4943(a) liability when an unrelated third party exercised its property rights on an ownership interest in a jointly owned business enterprise. This was done at a time, and in a manner that made it difficult for the foundation to identify its risk in a timely manner despite prudent precautions.
- Example: The foundation incurred a Section 4945(a) liability when it gave scholarships for the first time without obtaining advance approval of its scholarship procedures. Upon review of its procedures, an EO specialist determined that the procedures met the criteria for advance approval at the time the scholarships were originally given.
- Example: The foundation relied, in good faith, on the written, reasoned advice of an attorney or accountant (dated before the transaction) that the transaction wasn't subject to Chapter 42.

*From Exempt Organizations Technical Guide TG 58 Excise Taxes on Self-Dealing under IRC 4941 (p. 77)

Examples of "Likely non-abatement (though pertinent facts must be considered)"*

- Example: The foundation's officers, directors, and representatives state they were ignorant of the provisions of the law.
- Example: The Form 990-PF return for the tax period was prepared by a compensated attorney, accountant, or enrolled agent. The return gave no notice that a specifically identified questionable transaction had occurred.
- Example: The foundation, a related foundation, or a predecessor foundation had a previous Chapter 42 tax amount abated under Section 4962 for the same type of taxable event.
- Example: The taxable transaction wasn't identified as a potential violation of Chapter 42 by any party until an examination began.

*From Exempt Organizations Technical Guide TG 58 Excise Taxes on Self-Dealing under IRC 4941 (p. 78)

Document, document, document

- Ensure you have easy access to basic organization documents
  - Application for exemption, Forms 990-PF/990-T (disclosure obligation)
  - Organizational documents and board meeting minutes
- Document who your disqualified persons are and the procedure you use to ensure your list stays current
- Where activities/transactions may raise concerns, add documentation to clarify "there's nothing to see here"
  - E.g., document that permitted transactions with DPs were at fair market value or how a PRI will further the foundation's charitable purposes
  - Memos to file to fill in gaps in original documentation can be useful – but only if in the file before an exam begins.

➢ Goal is to demonstrate that the foundation has acted reasonably and in good faith to comply with the law.

Document, document, document (some more)

- Document how your activities further your charitable purposes
  - Ensure your Form 990-PF and website are consistent with organizing documents; additional documentation may help.
  - Operating foundations may need robust documentation of their *direct* charitable activities – particularly if they are also making grants
  - More pressure on foundation charitability and operating status if donor is making non-cash contributions and taking large deductions
- Document which persons providing services to the foundation are employees and which are independent contractors.
  - Volunteers (and contributed labor) may raise 4960 issues

Self-Dealing and Conflicts of Interest

Conflicts of Interest

Common conflicts of interest / potential self-dealing

- Co-investing – Private foundations often invest alongside a family office investment fund, not realizing that the purchase of sale of LP interests in what may be a disqualified person (the fund) may constitute self-dealing.

- Cost-sharing – Private foundation barred from paying rents to a disqualified person, but it may pay for professional/management type services so long as the compensation is just and reasonable.

- Director fees – Typically explicitly permissible under state law, inherently a conflict of interest. (Note that for public charities, the "rebuttable presumption of reasonableness" is not available, since establishing it requires the vote of an uninterested board.)

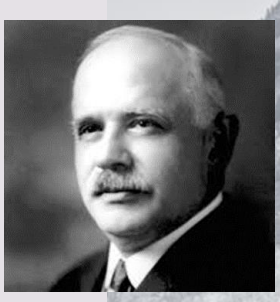
- Gifts subject to debt/liabilities – the contribution is treated as a sale, with the consideration equal to the amount of debt/liability being "unloaded" on the nonprofit. Such a sale or exchange can be impermissible self-dealing when a private foundation is involved.

Common conflicts of interest / potential self-dealing

- Personal pledges
  - It is self-dealing for a nonprofit to satisfy a legally binding debt of a disqualified person.
  - The foundation should not be fulfilling a disqualified person's pledge to another charity.
  - What about another charity's "give or get" requirement for board members?
- Ticketed fundraisers
  - No bifurcating.
  - Okay to attend to monitor and review the grantee's operations. They tend to put on quite a show –a grant request guised in "the old song and dance."
  - Can you avoid self-dealing by giving the tickets away? To who? A spouse? A business associate?
  - Is that personal business development, or are you giving the ticket to a potential future grantor to that organization?

In the Matter of the Otto Bremer Trust

State of Minnesota Court of Appeals, A22-0906, 984 N.W.2d 888 (Jan. 17, 2023)



According to the Internet/Wikipedia:

Otto was active in politics, "having lobbied against the Minnesota County Option Law in the 1890s, a law that would have allowed counties to institute alcohol prohibition. Following his brother's death in 1939, Otto served as President of Schmidt's Brewery."

In 1934, Otto's nephew was kidnapped by the Karpis-Barker gang in broad daylight, as he was dropping off his daughter at school in St. Paul. This kidnapping, together with that of brewing heir William Hamm, Jr., brought an end to the O'Connor agreement, whereby St. Paul Police Chief John O'Connor allowed such gangsters to use St. Paul as a safe haven, provided they committed no crimes within the city. Ransoms were paid, and both victims were released unharmed.

Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Ponar Foundation

In the Matter of the Otto Bremer Trust

State of Minnesota Court of Appeals, A22-0906, 984 N.W. 2d 888 (Jan. 17, 2023)

In rejecting the appeal of Trustee Brian Lipschultz, the Minnesota Court of Appeals found that a Minnesota "district court does not abuse its discretion when it removes the trustee of a charitable trust: (1) who has engaged in a series of breaches of trust that collectively constitute 'a serious breach of trust' … or (2) whose repeated improprieties demonstrate that removal is in 'the best interest' of the charitable trust and its beneficiaries..."

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In the Matter of the Otto Bremer Trust

State of Minnesota Court of Appeals, A22-0906, 984 N.W. 2d 888 (Jan. 17, 2023)

- The Trust incurred an IRC excise tax on self-dealing. Lipshultz admitted that he used the Trust's resources for non-Trust purposes and that this constituted self-dealing under the IRS code. He reimbursed the Trust $1,875. Lipschultz did not reimburse the $4,762.80 the Trust paid the accounting firm or the legal fees the Trust incurred in remediating the self-dealing.

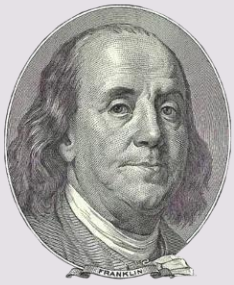
  "[E]ven assuming that Lipschultz's personal use of the Trust's assets was 'de minimis,' there is no 'de minimis defense' to whether self-dealing violates the duty of loyalty." (Personal use of staff time, postage, and computer resources.)

- Does the court conflate the IRC section 4941 strict liability standard for self-dealing with the fiduciary standard of care?

State AG Investigations

A Dozen Things to Deal With

Audits / Investigations



"An ounce of prevention is worth a pound of cure."
Benjamin Franklin

Basic response framework

- While this discussion is somewhat (somewhat) specific to fraud and embezzlement of one form or another, the basic response framework is largely applicable to other situations such as:
  - criminal behavior by key employees, etc.
  - data privacy leaks
  - responding to Attorney General investigations
  - responding to IRS and state tax audits

A suspicion of fraud, embezzlement or other serious wrongdoing should trigger at least a dozen things to think about:

Internal nondisclosure agreements

Internal investigations (briefly…)

Public relations/communication plans

Insurance. Any coverage? Theft, D&O, Cyber Insurance, Legal Fees, etc.

Indemnification requirements

Board liability issues

Employee release/settlement agreements

Make it right - Seeking restitution of misappropriated assets – ACT FAST!!!

Governmental notice requirements (IRS, AG, District Attorney, Police, etc.)

Prevention – Immediate security issues and enhanced financial controls

Tax-exempt status / private inurement / private benefit issues

Succession plans

Timing

- Well, it depends, but be quick about it (and get an engagement letter first).
- The dozen items we'll cover are not in chronological order.
- In one situation, a multi-faceted initial process was employed as soon as the internal investigation reached a high degree of certainty
  - a demand by the Chair for signature on a resignation letter by the embezzler
    - Where should this take place? In a public place? With security present?
    - Call the HR department!
  - followed by the full board meeting (expect cantankerous beginnings… the evidence you present should be rock solid to bring the embezzler's former backers around)
  - followed by delivery of a release agreement (not a mutual release)

Timing

- At the same time…
  - Locks and passwords were being changed
  - Banks were notified of the removal of the embezzler's signature authority
  - Credit cards were cancelled
  - Email accounts were taken over, and
  - Building security was notified.

One: Internal nondisclosure agreements

- Consider the value of having each board member sign an agreement not to disclose (what they are about to hear).
- Directors may balk at being asked to sign a nondisclosure agreement before being told what is going on.
- They should be given a fairly vague explanation as to what has been going on.
- They are not required to sign, and may well refuse to do so, but "we are looking for solidarity in our approach and are hoping that all will agree to do so."
- It is recommended that counsel attend this initial meeting, in part to explain the nondisclosure agreement and to answer questions about the process going forward (you know, the other 11 items on the agenda).

Two: Internal investigations (sometimes, a "mock audit")

- A significant aspect of crisis management is finding out what happened, exactly:
- Source of the fraud?
- Is it ongoing?
- How long has it been going on?
- How much has gone missing? How much is owed?
- How many heads must roll?
- Who can and should conduct the internal investigation?
- Important reminder: While a full and frank discussion is a necessity, take the extra time needed to ensure that the internal investigation and its findings fall within the attorney-client privilege. See In re: Kellogg Brown & Root, Inc., No. 14-5055 (June 27, 2014) for a discussion of the A/C privilege with respect to internal corporate investigations.

Two: Internal investigations: Who Should Conduct the Investigation? Who is the Client?

- If the "diversion" is small, involves non-management employees or only outside "threat actors", and is limited in duration, then internal audit personnel or in-house counsel may conduct the investigation and report to management.
- If management or the board may be involved, or there are significant amounts involved, independent outside counsel and, perhaps, forensic auditors, should be retained to conduct the investigation.
- "Independent" counsel should not have any prior relationship with the organization or the individuals involved. Make clear in the beginning of the investigation that counsel must have unlimited access to people and documents, and will go wherever the facts lead them.
- The A/C privilege generally applies to communications with outside counsel, if made for the purpose of obtaining legal advice.
- The client may be the organization with the board and management as the point of contact to whom counsel reports. The client may be the board, the audit committee, or a disinterested special committee of the board.

Two: Internal investigations – Developing the Facts

- All documents should be secured at the outset. All document destruction should be ceased.
- Decide on a liaison with the organization for development of facts. The liaison should be someone with a solid institutional knowledge of organization, its operations and records, and can identify the people with relevant information.
- Review internal and external documents (files, emails, calendars, telephone logs, banking records, etc.).
- A forensic accountant may be advisable. Consider whether he/she should be engaged by outside counsel to seek to ensure that the A/C privilege applies.

Two: Internal investigations – The Report

- Mark it as Attorney-Client Privileged and Attorney Work Product.
- Prepare a balanced presentation that details how thorough the investigation has been and how well the facts are or are not substantiated by the evidence. Distinguish fact from opinion.
- Describe how the organization became aware of the fraud/diversion, steps taken in the investigation, facts developed (including a chronology), law and analysis, and reporting issues.
- Be careful with recommendations, suggested corrective measures and implementation plans. Decide in advance whether they should be included.

Three: Public relations/communication plans

- Go public?
- Disclosure waives the attorney-client privilege.
- Externally, the full board should discuss whether there is any need to quietly approach key stakeholders to explain what happened, largely to prevent any surprises if and when they get wind of the situation otherwise.
- Consult with a public relations expert in order to develop a communications plan if this does come out or, at the very least, know who you'll call if it does. Work together!

Four: Insurance. Any coverage? Theft, D&O, Cyber Insurance, Legal Fees, etc.

- Verify the nonprofit's theft loss coverage or directors and officers insurance ("D&O").
- The extra layer of statutory protection from liability applicable to volunteer directors of nonprofits, both at the federal and state levels in some cases, require certain minimum insurance coverage. Volunteer Protection Act of 1997.
- Review with the organization's insurance broker all of the potentially applicable coverages (including for legal fees incurred).
- *Keep an eye on "cyber insurance."* A common crisis that has plagued many an organization lately is hacking (i.e., data privacy breaches). Does the organization collect credit card numbers of people attending an event? Does the organization have other sensitive donor, done, student or other grant recipient/patient data?

Five: Indemnification requirements

- Determine and explain to the board that you, of course, have a robust indemnification provision in the bylaws, calling for the maximum level of indemnification permitted by law.
- Especially if that isn't the case, consider having the organization enter into separate indemnification agreements with each director, and include a "tail" on the indemnification requirement to cover former directors for a certain period of years.

Six: Board liability issues

- Consider what the investigation/audit has turned up. Was there any self-dealing by directors? Did anyone aid and abet the bad actor?
- Explain the limitations on statutory protections / indemnification provisions.
- Fiduciary duties: Duty of Care / Duty of Loyalty / Avoiding "Corporate Waste"
- Does the avoidance of corporate waste require the pursuit of restitution? At any and all costs?
- What can be taken into account? How much is "keeping this quiet" worth to the organization?
- Consider the business judgment rule.

Seven: Employee release/settlement agreements

- Under the circumstances, and to seek to limit both board and organizational liability, the strategic approach may be to serve up a release, but not a mutual release.
- Hopefully, the release would effectively remove all of the fraudster's potential claims against the organization (retaliatory perhaps, but consider age discrimination, sexual harassment and other potentially "noisy" lawsuits).
- "Complete and General Release by [Bad Guy] of All Claims, Known or Unknown"
- In exchange, the organization could promise not to disparage the bad actor to potential new employers (i.e., agree to provide nothing more than their title and years of service).

Eight: Make it right - Seeking restitution of misappropriated assets - Keep the Board Focused on Restitution, not Retribution

- Aside from the release, the full board should discuss whether and how to pursue restitution of the misappropriated assets.
- Call the banks! Call the FBI! The Secret Service! The SBA?
- How much will insurance cover? The amounts embezzled or lost through fraud, via hacking, identity theft? The costs of seeking restitution? What do the annual deductibles add up to? How much will this all cost to deal with? Lawyers/PR Consultants/etc.
- Does the insurance policy include a subrogation clause, permitting the insurer to pursue civil collection claims against the fraudster? What level of involvement will be required of the organization?
- To avoid "corporate waste," should the organization pursue its own civil claims for uninsured losses, costs and expenses? What would a cost/benefit analysis say?

Nine: Governmental notice requirements (IRS, AG, District Attorney, Police, etc.) – Briefly…

- As the investigation unfolds, determine what governmental notices will be required, if any (e.g., IRS, Attorney General, etc.).
- If required, color those in the best light possible from the organization's perspective, including steps taken to amend its governance and financial controls to prevent any further such losses.
- Example: "The Board was informed of the situation at a special meeting of the Board held on _____. A nine member team of directors was then assembled, led by _____, to conduct a full and detailed forensic accounting of all financial dealings involving [Bad Guy]. The ongoing investigation has uncovered various methods by which the financial improprieties were undertaken specifically to evade detection by the Corporation's financial controls, and the Board has since substantially strengthened its internal controls and fiscal management systems to prevent any further fraudulent diversion of its charitable assets."

Nine: Governmental notice requirements (IRS, AG, District Attorney, Police, etc.) – Briefly…

- Don't forget to ask for confidentiality: "The [organization] will fully assist you with any investigation you should undertake into this matter. However, [the organization] respectfully requests that you maintain the information provided herein on a confidential basis, disclosing this letter only on a need-to-know basis within your respective organizations."

  (Then, tell them why confidentiality is important to the organization.)

Nine: Governmental notice requirements – Attorney General

- Should we tell the AG?
  - What Best Serves the Client's Interest?
    - The board owes a duty of loyalty to the organization, not to an embezzler
    - Notifying the AG may send the right message internally and externally
    - Does disclosure result in waiver of attorney-client privilege?
  - Notifying the AG is in the public interest. If you don't notify the AG, the fraudster can go after the next nonprofit. Contrast this with the desire to have a release signed, where the only consideration provided may be the promise to provide only the title of years of service to potential future employers calling for reference.
- Challenges in Making a Decision
  - Directors may be concerned with personal liability
  - The AG's investigation will not be limited to the perpetrator

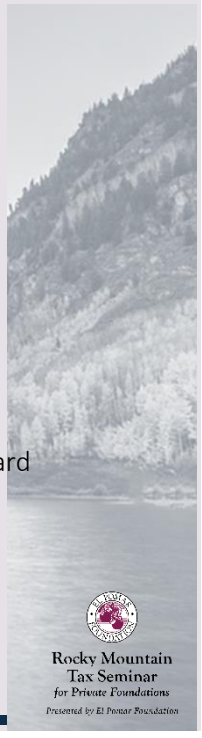
Nine: Governmental notice requirements – Attorney General

- Advantages of Disclosure
  - Limited resources: if the AG is satisfied that the organization is conducting a thorough and independent investigation, the AG is less likely to investigate.
  - The AG is more likely to be comfortable that an active board is providing due care if the board is thoroughly investigating an alleged violation and installing preventative measures.

    Get a thank you letter, rather than a subpoena!
    - Contrast this with the AG finding out about the issue through the press or a whistle blower.
  - If an investigation becomes public, the board can tell the press that it is independently investigating the matter and fully cooperating with the AG, which may limit reputational harm to the organization.

Nine: Governmental notice requirements – Attorney General

- How to contact the AG
  - A call or letter to an AG representative in the charity division; phone or email to ascertain interest.
  - Be prepared to share everything: evidence, witnesses, board steps taken, investigation/litigation steps proposed, proposed new financial controls, etc.
  - Evidence provided to the AG typically remains confidential during the AG's investigation.
- What to expect when you contact the AG. Discussion about:
  - Whether AG wants to pursue an investigation, and if so, whether simultaneously with board investigation or after its conclusion.
  - Whether organization, AG, or both will bring a lawsuit seeking restitution, removal, etc. and/or will attempt to negotiate a settlement.
    - AG has credibility and resources, and is often not subject to same defenses
    - Who will take lead role in any lawsuit where AG and organization join forces?



Nine: What the AG Does About Fraud / Embezzlement

- AG Outcomes and Goals Differ based on the Circumstances
- Could Include
  - Removal of Director(s)
  - Non-Consensual Dissolution (Judicial)
  - Receivership
  - Agreed Upon Remedial Actions
  - Forensic Audit
  - IRS Referral (Inurement/Excess Compensation)

Nine: Governmental notice requirements – Internal Revenue Service

Form 990-PF (2022) Page 5

Part VI-B Statements Regarding Activities for Which Form 4720 May Be Required

File Form 4720 if any item is checked in the "Yes" column, unless an exception applies.

			Yes	No
1a	During the year, did the foundation (either directly or indirectly):			
	(1) Engage in the sale or exchange, or leasing of property with a disqualified person?	1a(1)		
	(2) Borrow money from, lend money to, or otherwise extend credit to (or accept it from) a disqualified person?	1a(2)		
	(3) Furnish goods, services, or facilities to (or accept them from) a disqualified person?	1a(3)		
	(4) Pay compensation to, or pay or reimburse the expenses of, a disqualified person?	1a(4)		
	(5) Transfer any income or assets to a disqualified person (or make any of either available for the benefit or use of a disqualified person)?	1a(5)		
	(6) Agree to pay money or property to a government official? (**Exception.** Check "No" if the foundation agreed to make a grant to or to employ the official for a period after termination of government service, if terminating within 90 days.)	1a(6)		
b	If any answer is "Yes" to 1a(1)–(6), did **any** of the acts fail to qualify under the exceptions described in Regulations section 53.4941(d)-3 or in a current notice regarding disaster assistance? See instructions	1b		
c	Organizations relying on a current notice regarding disaster assistance, check here ☐			
d	Did the foundation engage in a prior year in any of the acts described in 1a, other than excepted acts, that were not corrected before the first day of the tax year beginning in 2022?	1d		

Ten: Prevention – Immediate security issues / enhanced financial controls

- Immediate:
  - Change locks and passwords
  - Notify banks and lift embezzler's signature authority
  - Cancel credit cards
  - Take over email accounts and computer systems
  - Notify building security
  - Update internet security, protocols, software

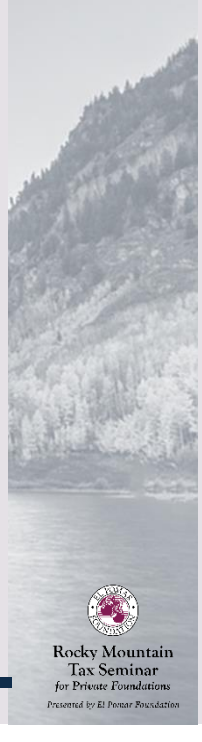
"An ounce of prevention is worth a pound of cure."
Benjamin Franklin

Ten: Prevention – Immediate security issues /enhanced financial controls

- Structural changes:
  - Limit computer system entry points, require two-factor identification, regular security trainings for all personnel
  - Data mining for leaks, identity theft, fraudulent loans
  - Adopt a conflict-of-interest policy and annual director conflict disclosure questionnaires
  - Establish a formal whistle-blower policy
  - Review credit card use and purchasing protocols, investment fund transactions
  - Restrict meals and entertainment expenses
  - Establish dual-stage check writing and electronic transfers, asset trading approval process (Trust and Verify)
  - Consider who opens the mail, and how incoming checks and cash are handled
  - Establish an audit committee

Eleven: Tax-exempt status / private inurement / private benefit issues

- While well beyond the scope of this presentation, consider whether the situation implicates the organization's tax-exempt status.
- Did the acts give rise to private inurement, private benefit, or self-dealing?



Twelve: Succession plans

- Finally, now that the board is utterly exhausted…
- Or, try to get this process rolling early on, so that there is an executive search already well under way by the time the dust settles.
- Do the Bylaws determine who the acting [insert fraudster's title here] is until the office is filled?

Thank You

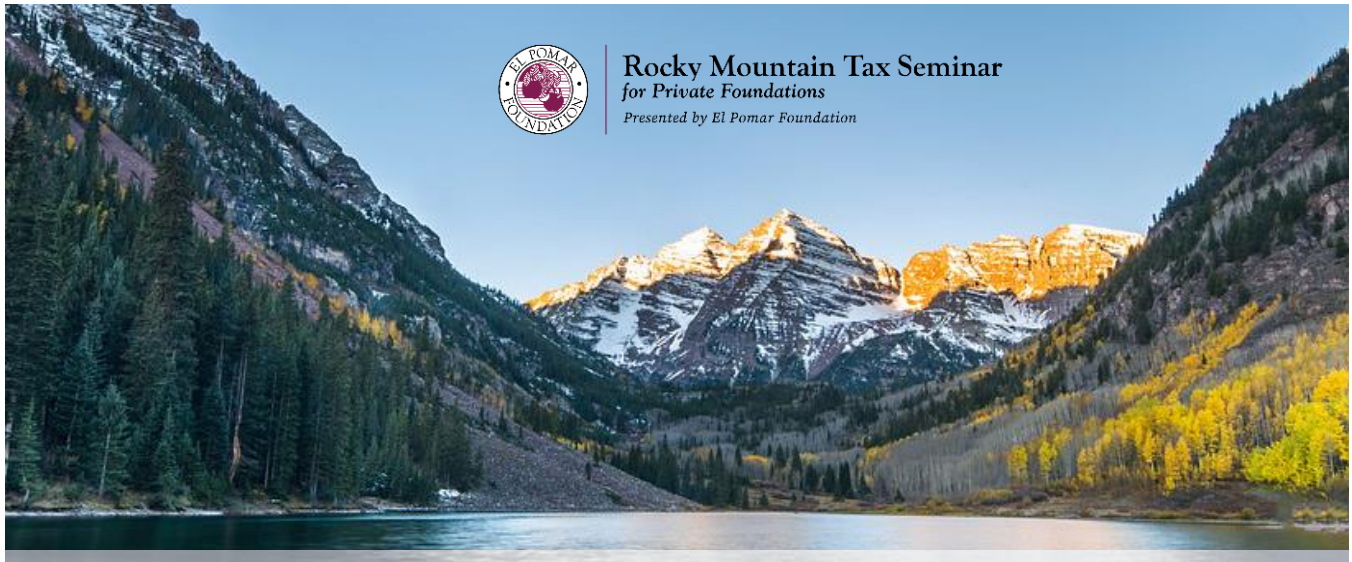
Ofer Lion - Seyfarth Shaw LLP
Ruth Madrigal - KPMG

KPMG

kpmg.com/socialmedia

Preparing Foundations for IRS and AG Investigations

Ofer Lion and Ruth Madrigal



Designing & Structuring Joint PRIs

Krysta C. Copeland
kcopeland@rockfound.org
September 14, 2023

AGENDA

How we, as charitable private foundation investors, can get comfortable making PRIs alongside a bunch of for-profit investors

A. PRI Refresh
B. What About MRIs?
C. PRI Elements & Tensions
D. Structuring Strategies
E. Causes for Pause
F. Key Takeaways

A. PRI Refresh

SPIRIT OF THE PRI

A Program-Related Investment ("PRI") is a powerful tool that private foundations can use to create a ripple effect of philanthropic impact

- Can increase charitable funds available for foundation deployment
- Can increase funds available for the PRI recipient to deploy toward charitable purposes

>>> PRIs go where traditional grants cannot and where conventional investments should not

OTHER PRI BENEFITS

From a regulatory perspective…

- Qualifying Distributions
- UBTI
- Excess Business Holdings rules
- Jeopardizing Investments rules

TAX FRAMEWORK

Ordinarily, a foundation should make prudent investments and avoid jeopardizing investments

- Jeopardizing investments show a *lack of reasonable business care* in providing for the financial needs of the foundation
  - Punitive excise taxes
- PRI Exemption: program related investments "shall *not* be considered as investments which jeopardize the carrying out of exempt purposes"

Therefore, a foundation may make investments that are risky or a seemingly imprudent use of endowment funds, so long as they are properly structured PRIs

B. WHAT ABOUT MRI'S

QUICK PSA: PRIS VS MRI'S

This tension doesn't exist with mission-related investments. WHY?

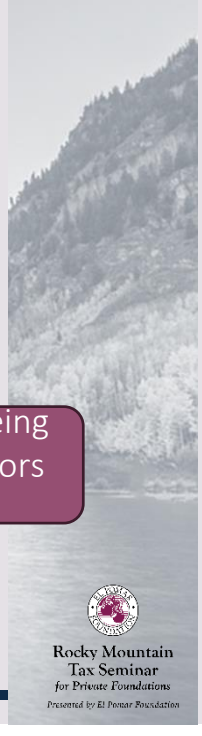
MRIs are prudent

"Impact Investments"

Don't have the same hurdles or benefits as PRIs

- Qualifying Distributions
- UBTI
- Excess Business Holdings rules
- Jeopardizing Investments rules

>>> As an MRI investor, seeing a bunch of for-profit investors is OK, if not preferable



C. PRI ELEMENTS & TENSIONS

CORE ELEMENTS OF PRI'S

<u>Each</u> must be true:

1. **Primary purpose** is to accomplish one or more of the foundation's exempt purposes
2. **No significant purpose** is the production of income or appreciation of property
3. **No purpose** is influencing legislation or taking part in political campaigns

>>> PRI determination is made at the time the investment is made

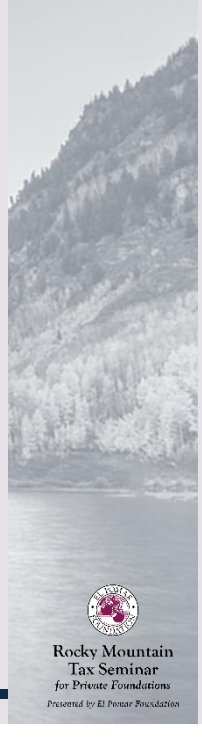
INHERENT TENSIONS

✓ **PRI**: by definition, financially imprudent
X **Commercial investment**: for-profits generally aren't making imprudent investments

X **PRI**: cannot be profit-motivated
✓ **Commercial investment**: primarily profit-motivated

→ So how can we make PRIs work alongside co-investors that are primarily, if not solely, concerned with profit?

D. STRUCTURING STRATEGIES



STRUCTURING CHARITABILITY

- Clear, relevant, measurable charitable objective(s)
  - Consider a charitability outline at outset of negotiations*
    - Bonus: charitability screen and minimum thresholds

Safeguarding Charitability

>>> Generally accomplished through a side letter

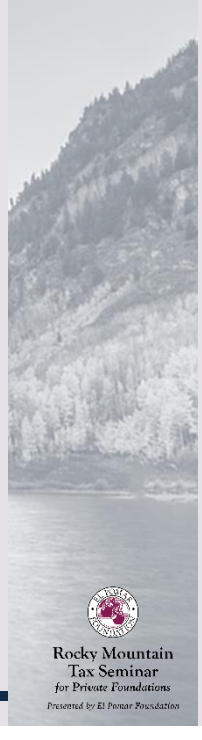
- LPAC representation*
- Board/IC observer rights*
- "Major Investor" status
- Excuse Rights (in addition to withdrawal/redemption)
- Equity Kickers (also mitigates private benefit)
  - Convertibility*
  - Warrant

Sample Charitable Purpose – Fund

The Foundation represents to the General Partner, and the General Partner acknowledges, that the Foundation's primary purpose in making the Investment is to accomplish the charitable (within the meaning of Code Section 501(c)(3) and 170(c)(2)(B) and the regulations thereunder) purposes of:

(i) **combatting environmental deterioration and promoting the revitalization, protection and preservation of the natural environment, to support life and livelihoods, including populations most vulnerable to the negative impacts of climate change in order to meaningfully and measurably contribute to climate change mitigation and adaptation** by [*increasing the sequestration and removal of atmospheric carbon dioxide, improving biodiversity, and conserving water*], and

(ii) **providing relief to the poor, distressed, and underprivileged** by [*improving lives, increasing economic opportunities, and enhancing the health and safety of low-income individuals*].

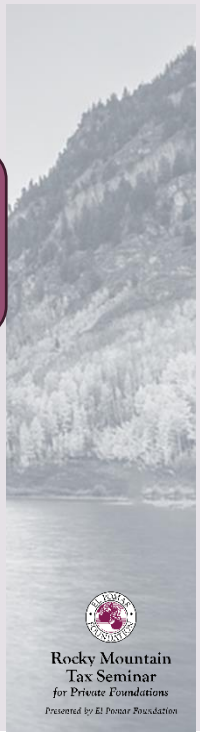


STRUCTURING THE DEAL

Debt Strategies (relative to for-profit investors)

- Lower interest rate
- Longer repayment term
- Unsecured or junior tranche
- Recycling*
  - all or a portion of what would otherwise be repaid
- Interest accrual holiday
  - grace period during which interest does not accrue
- Repayment tied to charitable milestones
  - Ratchet down repayments once interim goals are achieved
  - Single review date during which rate can be adjusted/eliminated

>>> Use these features individually or in any combination



Structuring the Deal

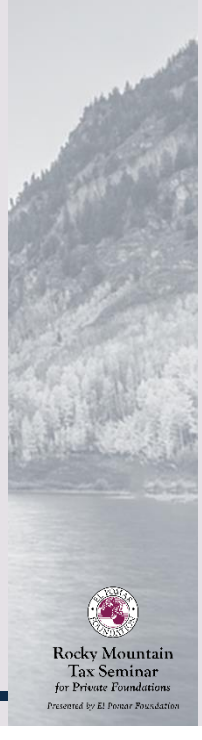
Equity Strategies (relative to for-profit investors)

- First close/seed stage
- Common equity in a structure that includes preferred
- Subordinated class
  - Delayed return of capital
  - Lower preferred return
  - First clawback
- Recycling*
  - All or a portion of what would otherwise be repaid

SAMPLE RECYCLING PROVISION

All funds that the Partnership receives from any portfolio company as repayment in respect of any recoverable loan disbursed to such portfolio company (the "Recovered Funds") shall be held by the Partnership and reported to the Partners on at least a quarterly basis pursuant to Section XX of the Partnership Agreement. Recovered Funds apportioned to the Foundation may be (1) returned to the Foundation[, in an aggregate amount up to XXX] or (2) with the consent of the Foundation, allocated in whole or in part to one or more portfolio companies in accordance with the Partnership Objectives, so long as the repayment period falls within the Term.

E. Causes for Pause



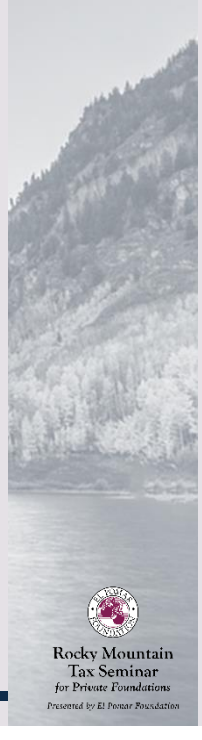
PAUSE & RE-ANALYZE

- Post-closing changes (amendments, extensions, consents)
- Restructuring requests
- Follow-on opportunities
- Co-investment opportunities
- Successor Funds and subsequent rounds

IRS: Once an investment is determined to be a PRI, it will continue to qualify as a PRI if changes to the form or terms are made **primarily for exempt purposes** *and* **not for any significant purpose involving the production of income or the appreciation of property**.

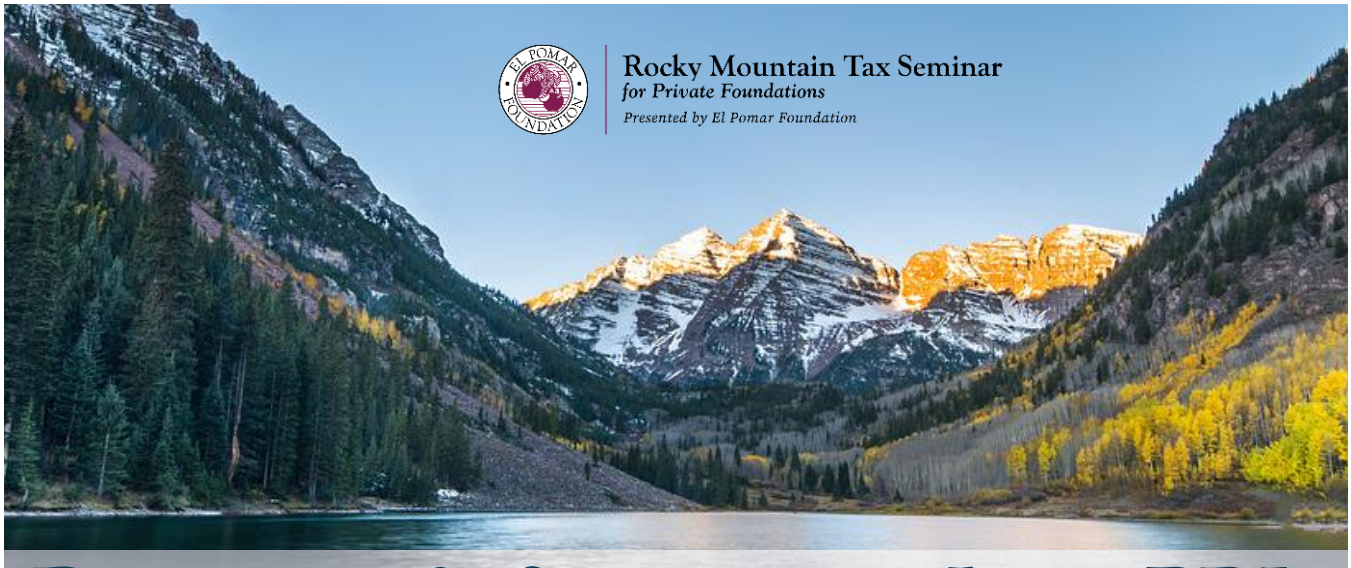
Changes made **for the prudent protection of the foundation's investment** will not ordinarily cause the investment to cease to qualify as a PRI. However, a PRI may cease to be program-related because of a **critical change in circumstances**, such as serving an illegal purpose or the private purpose of the foundation or its managers.

F. Key Takeaways



NONPROFIT ≠ NO PROFIT

- The presence of more commercial, for-profit investors does not automatically prevent an investment from being a valid PRI
- A valid PRI will not be disqualified because of the potential for a high rate of return, or even because of actual income production or property appreciation
- PRIs tend to be extremely catalytic, helping to attract private capital toward charitable purposes in a way that effectively serves people, planet and (private) pockets
- PRIs can create impact far greater than the sum of the individual parts



Designing & Structuring Joint PRIs

Krysta C. Copeland
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September 14, 2023

Designing and Structuring Joint PRIs – Supplemental Materials

Sample Initial Charitability Outline for Discussion – Fund

Charitable Purposes:

The Foundation is making the investment in furtherance of the following charitable purposes:

- *Relief of the poor, the distressed, or the underprivileged* – Support relief of the distressed and underprivileged by enabling the fund to (1) support businesses that provide employment opportunities to Ukrainians, living within Ukraine or forced to relocate outside of Ukraine, being affected by the ongoing conflict within the country and/or to Moldovans as Moldova is disproportionately impacted by this conflict in Ukraine given its proximity as well as having taken in the highest number of Ukrainian refugees per capita of any country ("Vulnerable Individuals") by sustaining and creating meaningful jobs, and (2) support businesses employing Ukrainians and Moldovans that are owned or led by people who have historically been underserved, underfunded, or discriminated against, with a primary focus on women (each a "Vulnerable Business").

- *Combating community deterioration* – Support the combating of community deterioration by enabling the fund to provide investment and operational support to Vulnerable Businesses in order to help them continue local operations, employ Vulnerable Individuals, provide critical goods and services to local communities, and pay taxes to fund essential public expenditures.

Qualified Charitable Investment ("QCI"): a Portfolio Investment in a Vulnerable Business or which provides measurable employment opportunities to Vulnerable Individuals, in each case measured at the time of investment.

QCI Threshold & Charitability Default:

- General Partner will cause the fund to use the proceeds from the Foundation's investment solely to further the Charitable Purposes in accordance with the LPA and Foundation side letter (initial requests below)
- So long as the Foundation entity holds the investment, GP will ensure that at least XX% of the fund's invested capital is in QCIs (the "QCI Threshold")
- Failure to maintain the QCI Threshold may be deemed a Charitability Default by the Foundation in its discretion. Misuse of funds will also be deemed a Charitability Default. Upon notice of a Charitability Default, the fund will have XX days to rectify or propose a written rectification plan designed to achieve compliance within XX days from the notice of default. If no rectification within such XX- or XX-day period, the Foundation may demand redemption of that portion of the commitment as is necessary to bring the fund back into compliance. During the period in which a Charitability Default has occurred and is continuing, the Foundation's obligation to pay further drawdown notices will be suspended and the Foundation will not be deemed a Defaulting Partner.

QCI Metrics and Targets (to be met at the time of each portfolio investment and reported promptly after the closing of each investment)

- Whether the company is Primarily Active in Ukraine and/or Moldova (the "Region")
    - [target > XX%]

- Share of jobs that are held by Ukrainians and Moldovans
    - [target > XX%]
- Whether the company is women-led or -owned (definitions TBD)
    - [target > XX%]

Other Impact Metrics (to be reported annually alongside annual reporting – will be an annex to side letter):

- Number of companies supported – total, total Ukraine, total Moldova
- Amount invested into portfolio companies – total, total Ukraine, total Moldova
- Number of companies that are small- or mid-sized at acquisition – total, total Ukraine, total Moldova
- Approximate share of dollars invested that remains in Ukraine and/or Moldova
- Portfolio company information – sector, location (HQ and primarily active), brief description
- Number of jobs – total, women, total Ukraine and total Moldova
- Number of jobs created – total, women, in Ukraine, high quality (definition to come)
- Average employee wages
- Number of women-led portfolio companies
- Number of women-owned portfolio companies
- Number of employees holding management positions – total, women
- Revenue and revenue growth per company
- EBITDA and EBITDA growth per company
- Subsequent capital (equity or otherwise) mobilized into portfolio companies at the time of and following fund's investment
- Fund commitments raised alongside the Foundation in the first close
- Fund commitments raised following the Foundation investment
- Approximate amount of company expenditures spent in Ukraine and in Moldova

Reporting Cadence:

- Standard fund reporting per Section [XX] of the LPA
- QCI Metrics: at time of investment
- Other Impact Metrics: annually
- Compliance statement: annual written statement signed by an authorized officer confirming compliance with the fund documents, summarizing progress towards achieving Charitable Purpose, number of QCIs and amount invested in QCIs to date
- Final impact report at earlier of end of term or Foundation exit
- Other information as reasonably requested by the Foundation to evaluate the effectiveness of the fund in achieving the Charitable Purposes or satisfying applicable private foundation requirements

Other Side Letter Requirements & Requests (Foundation can propose language where needed):

- LPAC/Observer
- Foundation will be provided with governing docs of any AIV, Parallel Investment Vehicle, Feeder Fund or Co-Investment Vehicle prior to investing through such vehicle, and side letter will apply to any such vehicle

- Standard prohibitions on lobbying, political activities, earmarking of funds
- OFAC compliance
- Books & records for at least 4 years
- Optional annual impact assessment by Foundation at Foundation's cost
- Disqualified Persons of Foundation are not connected to the fund [Foundation to send list of relevant persons]
- Confidentiality/use of name & logo only with Foundation consent

- **This is an initial indicative summary only, drafted in good faith in light of information received and documents reviewed to date. Everything herein remains subject to change, including additional requests as appropriate, following our review of the definitive fund documentation (as updated) and ongoing diligence conversations.**

Sample Side Letter Provisions

- Charitable Purpose (see also sample Charitability Outline)

The Foundation represents to the General Partner, and the General Partner acknowledges, that the Foundation's primary purpose in making the Investment is to accomplish the charitable (within the meaning of Code Section 501(c)(3) and 170(c)(2)(B) and the regulations thereunder) purposes of:

(i) **combatting environmental deterioration and promoting the revitalization, protection and preservation of the natural environment, to support life and livelihoods, including populations most vulnerable to the negative impacts of climate change in order to meaningfully and measurably contribute to climate change mitigation and adaptation** by [*increasing the sequestration and removal of atmospheric carbon dioxide, improving biodiversity, and conserving water*], and

(ii) **providing relief to the poor, distressed, and underprivileged** by [*improving lives, increasing economic opportunities, and enhancing the health and safety of low-income individuals*].

- LPAC

For so long as the Foundation is a Participating Shareholder of the Fund and is not a Defaulting Participating Shareholder, the Fund agrees that the Foundation may appoint one representative to serve as a voting member of the Advisory Committee pursuant to the terms and conditions set forth in [Section XX of the LPA]. In the event of the removal or resignation of such representative, the Foundation may identify and appoint a new representative. Should the representative be unable to attend any meeting of the Advisory Committee, the Foundation may request in writing that a proxy be designated to attend on behalf of such representative.

- Observer Rights

For so long as the Foundation holds the Investment and is not a Defaulting Partner, the General Partner agrees that the Foundation may appoint one representative to serve as a non-voting observer of the LPAC (the "Observer Rep"). In the event of the resignation of such Observer Rep, the Foundation may identify and appoint a new Observer Rep. Should the Observer Rep be unable to attend any meeting of the LPAC, the Foundation may request in writing that a proxy be designated to attend on behalf of such Observer Rep.

- Recycling

All funds that the Partnership receives from any portfolio company as repayment in respect of any recoverable loan disbursed to such portfolio company (the "Recovered Funds") shall be held by the Partnership and reported to the Partners on at least a quarterly basis pursuant to Section XX of the Partnership Agreement. Recovered Funds apportioned to the Foundation may be (1) returned to the Foundation, in an aggregate amount up to XXX or (2) with the consent of the Foundation, allocated in whole or in part to one or more portfolio companies in accordance with the Partnership Objectives, so long as the repayment period falls within the Term.

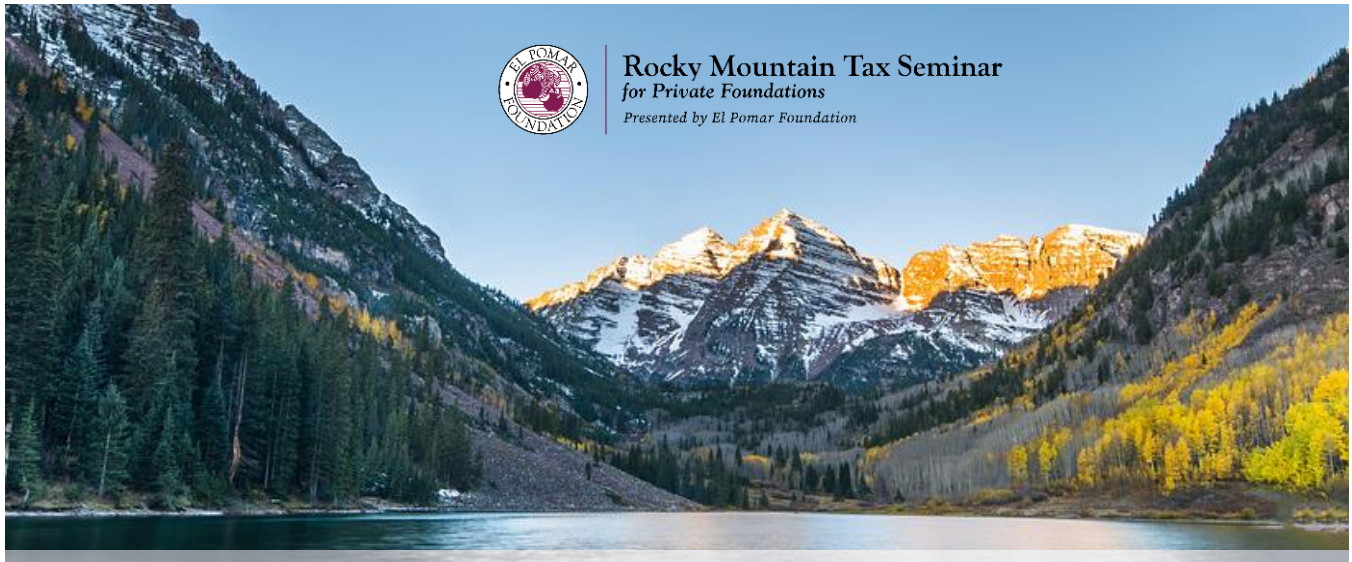
- Convertibility –
    - Note: this can be *automatic* (in which case, terms should be negotiated up front, and no further investment decisions are made, ie a SAFE) or *permissive* (in which case, terms

are negotiated at the time of a potential conversion, and a further investment decision must be made, ie a ROFO). A sample permissive provision is below.

Right of First Offer. If the Company raises or proposes to raise investment capital directly or indirectly at any time during the Term (a "Qualified Equity Financing"), then the Company agrees (a) to provide the Foundation the right to participate in such Qualified Equity Financing in an amount at least equal to $XXX (representing the aggregate amount of the Foundation's commitment, irrespective of amount disbursed) and (b) that, should the Foundation participate in a Qualified Equity Financing, the aggregate amount disbursed under this Agreement will be credited towards any such further investment by the Foundation in the Company. This right of first offer shall be exercisable by the Foundation in its sole discretion.

With respect to each Qualified Equity Financing, the Company agrees to promptly provide the Foundation with all relevant data and documents concerning the Qualified Equity Financing, which shall be at least equivalent to the information typically provided to prospective equity investors (collectively, the "Offering Materials"), as well as such further data and documents concerning the Qualified Equity Financing as the Foundation may reasonably request. The Foundation will have 60 calendar days from the date of receipt of the Offering Materials to confirm its intent to participate in the Qualified Equity Financing; if the Company receives no response during this time frame, the Foundation will be deemed to have declined the offer. The parties agree to negotiate the definitive terms of the Foundation's participation in good faith following the Foundation's receipt and review of all relevant information.

This right of first offer shall survive the Term only if the Foundation has received Offering Materials, and this right shall terminate at the end of the applicable 60-day consideration period.



PRACTICAL WAYS TO DEAL WITH A BREACH OF A GRANT OR PRI AGREEMENT

Celia Roady ~ September 14, 2023

OVERVIEW

- Grant Restrictions Under the Private Foundation Rules
  - Individual Grants
  - Grants to Public Charities That Lobby
  - Expenditure Responsibility Grants
- Program-Related Investments ("PRIs")
- Non-Tax Provisions in Grants and PRIs
- Ways to Minimize the Risk of a Breach
- Strategies for Addressing Breaches

INDIVIDUAL GRANTS

- The individual grant rules under Section 4945 require foundations to obtain reports showing that the grant recipients "performed the activities that the foundation intended to finance."
- When reports indicate that all or a portion of the grant was not used properly, the foundation has an obligation to take steps to recover the diverted funds and withhold further grant payments until the foundation is assured that further diversions will not occur.
- Foundations are not required to report individual grant diversions on their Form 990-PFs.

GRANTS TO PUBLIC CHARITIES THAT LOBBY

- A foundation is permitted to make grants to public charities that lobby under three circumstances.
    - A foundation may make a general support grant without including a prohibition against the use of grant funds for lobbying.
    - A foundation may make a grant to fund a project that involves lobbying if it includes a "no lobbying" prohibition in the grant letter.
    - Under the "project grant rule," a foundation may make a grant to support a project that includes a lobbying component as long as the foundation reviews the project budget, including the lobbying component, and determines that the amount of the grant does not exceed the nonlobbying portion of the project budget. The foundation does not need to include a "no lobbying" prohibition in the grant letter.
- To minimize the appearance of a breach in project grant rule grants, be clear that the grantee narrative and financial reporting is at the project level and does not require a report of the specific use of foundation funds.
- Similarly, do not require a general support grantee to provide an expenditure report on its use of foundation funds if there is a possibility that the funds may be used for lobbying.

EXPENDITURE RESPONSIBILITY GRANTS

- A private foundation is permitted to make a grant to an organization other than a public charity if the foundation exercises expenditure responsibility.
    - This requires the foundation to have a written grant letter with the grantee restricting the use of funds for charitable purposes, requiring the grantee to repay any funds not used for charitable purposes, and requiring the grantee to make annual reports and a final report on the use of grant funds the charitable accomplishments. The reports need to include a certification from the grantee that it complied with the terms of the grant. The grant agreement must also require the grantee to maintain books and records about the use of grant funds and make those available to the foundation for inspection.
    - If the annual or final report reflects a diversion of funds, the foundation is required to seek a return of the diverted funds and must withhold further grants pending such return and a determination that the grantee will not make further diversions.
    - Note that the tax laws do not require litigation or other efforts to seek a return of funds when that would likely be to no avail. There is no requirement to throw good money after bad.
    - The foundation is required to report diversions on its Form 990-PF as part of the expenditure responsibility reporting.

PROGRAM-RELATED INVESTMENTS

- A foundation is permitted to make a PRI in or to an organization other than a public charity, including a for-profit.
    - A foundation must exercise expenditure responsibility on PRIs by following the expenditure responsibility grant provisions and including some additional provisions in the PRI letter.
    - If the annual or final report reflects a diversion of funds, the foundation is required to seek a return of the diverted funds and withhold further grants pending such return and a determination that the grantee will not make further diversions.
    - The foundation is required to report diversions on its Form 990-PF as part of the expenditure responsibility reporting.

NON TAX PROVISIONS IN GRANTS AND PRIS

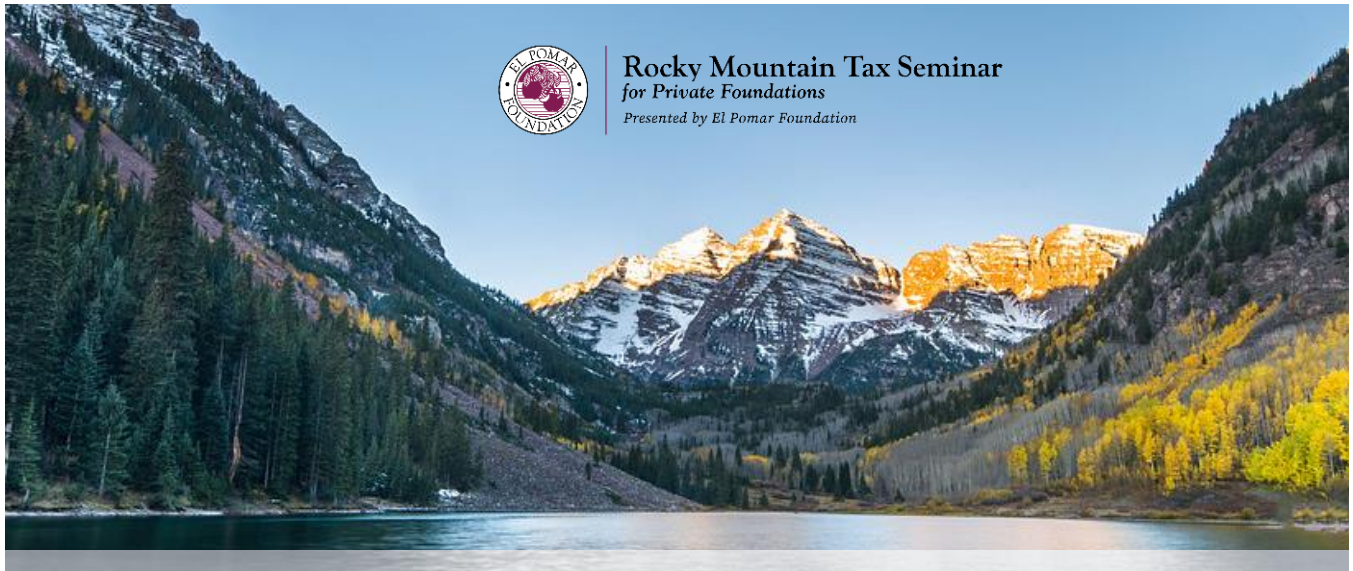
- In addition to the private foundation tax-related provisions, many foundations include provisions in grant and PRI agreements that are intended to serve other "business" purposes.
- Examples include IP provisions, such as a nonexclusive license to use IP generated with foundation funds for charitable and educational purposes; restrictions on the recipient's ability to merge or assign assets to third parties without the foundation's approval and assumption by the assignee of the grant/PRI obligations; the right to terminate the grant/PRI for reputational reasons; and similar provisions intended to protect the foundation and/or the foundation-funded work.
- Breaches of these provisions are governed by normal contract rights rather than the tax laws.

WAYS TO MINIMIZE THE RISK OF A BREACH

- Ensure that the agreement is clear about the consequences of a breach.
- Monitor grant/PRI reports carefully to identify areas of potential noncompliance; use inspection rights to determine whether the recipient used funds improperly.
- Make sure program staff stays in touch with grantees/PRI recipients.
- For PRIs in early-stage companies, consider seeking board observer rights.
- Build in protections against deliberate breaches, such as requirements to return the grant/investment amount with an interest/return component and/or that certain charitability requirements continue after termination.

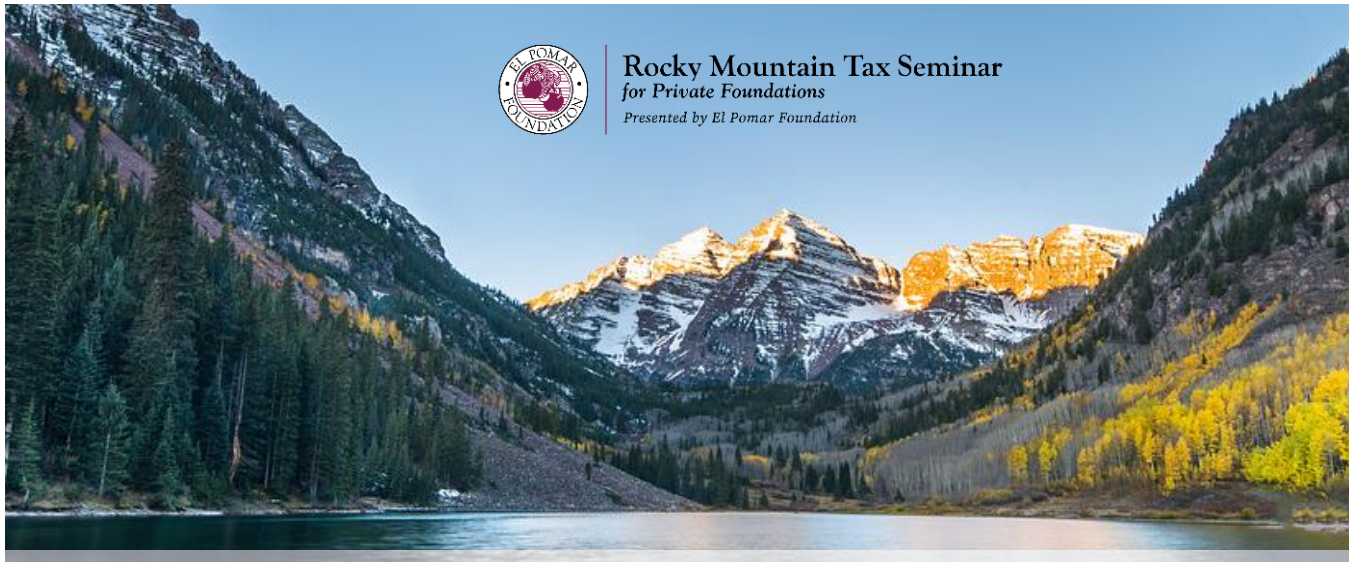
STRATEGIES FOR ADDRESSING BREACHES

- Be clear in the grant/PRI agreement that if the charitable purpose simply fails (for example, a clinical trial of a foundation-funded drug, vaccine or device is unsuccessful), this is not a breach.
- In the case of a diversion, determine whether diverted funds were used for charitable purposes (other than those specified in the funding agreement). If so, consider whether to modify the grant/PRI to permit that use of funds.
- This may happen when a grantee runs into financial difficulties and applies grant funds to another purpose that is charitable.
- Give the grantee/PRI recipient additional time to correct a breach, when correction seems feasible. The tax laws do not put time limits on the correction process.
- In the case of a PRI, if the recipient is unable to redeem the foundation's interest, consider whether to contribute the investment to a public charity or sell to a third party. This will allow the foundation to close out the PRI and end expenditure responsibility reporting.
- In the case of an expenditure responsibility grant/PRI, explain to the recipient that information about a breach has to be reported on form 990-PF and is therefore publicly available. This may provide additional leverage.



PRACTICAL WAYS TO DEAL WITH A BREACH OF A GRANT OR PRI AGREEMENT

Celia Roady ~ September 14, 2023



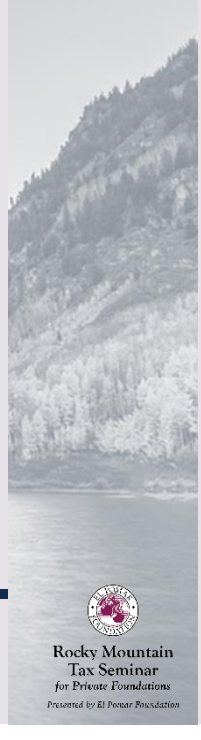
FOUNDATION USE OF CONTRACTS VS. GRANTS

Special Considerations for Research Efforts

Ann K. Batlle

OVERVIEW OF KEY CONCEPTS

- Foundations enter into arrangements with organizations and individuals for a variety of charitable purposes
- Agreements must be characterized for tax purposes as grants or contracts
- Required tax treatment is characterized differently for payments of grants vs. contracts
- Incorrect characterization of agreement as grant vs. contract can lead to significant tax penalties
- Goal of today's presentation is to review how to determine whether an agreement should be characterized as a grant or a contract, and discuss special considerations that arise in research contexts

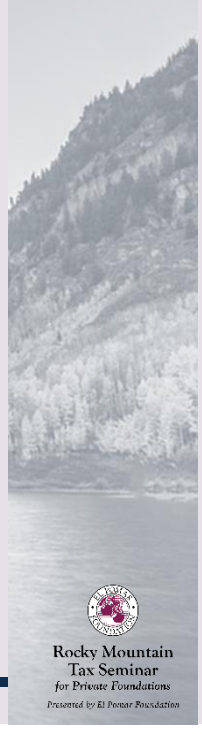


OVERVIEW OF SESSION

- Review legal definitions of grants and contracts
- Review differing tax treatment and penalties for incorrect classification
- Discuss how to decide whether an agreement is a grant vs. contract
- Discuss how to handle close cases
- Overview of considerations for private operating foundations

WHAT IS A GRANT?

- A grant primarily benefits the recipient in carrying out a charitable purpose
- If the recipient is a charitable organization, the grant provides funding to support the organization's charitable purpose
- If the recipient is a non-charitable organization, the grant provides funding to allow the recipient to carry out a charitable program or project for the benefit of the public
- If the recipient is an individual, the grant provides funding to help the individual achieve a specific objective, produce a report, or enhance a literary, artistic, musical, scientific, teaching or similar objective or talent of the recipient
- The Foundation funder does not derive direct benefits from grants, other than by furthering its mission



WHAT IS A CONTRACT?

- A contract provides a direct benefit to the funder
  - A contract may involve the performance of services that meet the direct and immediate needs of the funder
  - This may include services to support the funder in carrying out the funder's own charitable purposes, including planning conferences and programs
- A funder can enter into contracts with charitable organizations as well as noncharitable organizations, for-profit companies and individuals
  - Some charitable organizations, like Bridgespan or BoardSource, provide consulting services
  - If the services are provided to the funder, the arrangement is generally a contract
  - If the services are provided to other parties (such as foundation grantees), the arrangement may be a grant

IMPACT OF IP RIGHTS

- The IRS has indicated that a foundation's retention of IP rights is an indicator that the agreement is a contract
- Conversely, allowing the recipient to retain IP rights tends to indicate that the agreement is a grant
- In the research space, funders may seek IP rights (e.g., license rights) that are intended to provide benefits to other grantees or to the general public, so this is not always a dispositive factor in a contract vs. grant analysis

TAX ISSUES WITH GRANTS: WHY CORRECT CLASSIFICATION MATTERS UNDER SECTION 4945

- Section 4945 requires private foundations to exercise expenditure responsibility (ER) on grants to organizations other than public charities and foreign equivalents thereof
  - Foundations are subject to excise tax penalties for failure to exercise ER when required
  - Foundations must report ER grants or Form 990-PF; failure to report results in a taxable expenditure
- Foundations are required to follow IRS pre-approved grant procedures for most grants to individuals
  - Foundations are subject to excise tax penalties for failure to obtain prior IRS approval of individual grant procedures, or failure to follow procedures when making individual grants
- Foundations may be required to withhold on foreign grants if the grant involves activities in the U.S.
  - Foundations are primarily liable for failure to withhold at the proper rates

Tax Issues with Contracts: Why Correct Classification Matters for 1099 Reporting and Withholding

- Foundations may be required to issue 1099s to contractors
  - IRS imposes penalties for failure to issue 1099s and separate penalties for failure to obtain taxpayer identification numbers
- Foundations may be required to withhold on payments to foreign contractors
  - Foundations may have significant liability for failure to comply with withholding requirements

NON-TAX CONSIDERATIONS WITH GRANT VS. CONTRACT CLASSIFICATION

- Grants and contracts have different internal approval processes at a foundation and it's important to follow the correct approval process based on the type of arrangement
- Grants must be reported separately on Form 990-PF; disclosure includes the name of grantee and purpose of grant; there is no 990-PF reporting of contracts
- Contracts are characterized as administrative expenses on financial statements and Form 990-PF; some foundations set internal expense ratios that may push the characterization of certain arrangements as grants

CHARACTERISTICS OF GRANTS

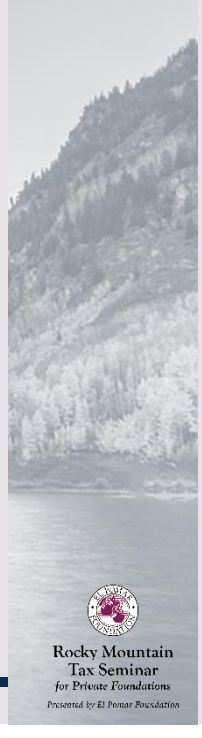
- The payment is for a scholarship, fellowship, internship, prize or award
- The Foundation receives no more than an incidental benefit from the performance of the funded activities
- The payment is to improve or enhance a literary, artistic, musical, scientific, teaching, or similar skill of the payee
- The payment provides support to further knowledge in a particular subject area or field of research
- The payee defines the scope and objectives of the project
- The payee is selected based on factors such as prior academic performance, etc.
- The payee produces a publicly available report that involves basic research or studies in public policy or the physical or social sciences
- The payee retains IP rights

CHARACTERISTICS OF CONTRACTS

- The Foundation receives the primary benefit from the performance of services
- The service is provided to serve the direct and immediate needs of the Foundation
- The Foundation and the payee jointly define the scope of work, methodology, timeline, and budget
- The Foundation uses the report provided by the payee for guidance in structuring its programs and activities
- The Foundation retains the right to IP
- The payment is for personal services to assist the Foundation in planning, evaluating, or developing projects or program activities by consulting, advising, or participating in conferences

CHARACTERISTICS OF CONTRACTS (CONT'D)

- Non-Section 501(c)(3) organizations would contract for similar services provided by the payee
- The payee is in the consulting business and regularly provides similar services to others
- The payee is retained as a replacement or substitute for the Foundation's employees
- The payee manages a Foundation project, offers technical assistance, and evaluates and monitors grant recipients
- The payee evaluates the Foundation's programs



IN THE UPSIDE DOWN: OPERATING FOUNDATION CONSIDERATIONS

- An operating foundation makes qualifying distributions "directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose."
- Thus, expenditures made for its own charitable purposes (e.g., may look more like contracts) are counted as "qualifying distributions" to determine its operating status
- Payments to individuals (e.g., for scholarships, fellowships, etc.) will only count as active conduct "qualifying distributions" if the foundation maintains "significant involvement" in charitable programs in support of which such payments or grants were made

EXAMPLE ONE

- The Foundation pays a stipend to an individual presenting a paper at a conference sponsored by a Foundation grantee. The stipend covers the presenter's travel, meals, and lodging expenses. This payment can be treated as a contract because the presenter has been asked to perform personal services—the presentation of the paper—that benefits the Foundation by helping to make the conference successful.
- In contrast, paying the same stipend to a graduate student who has an interest in the subject of the conference, but no particular expertise would be considered a grant. The graduate student, rather than the Foundation, is the primary beneficiary of the payment.
- Finally, the Foundation's payment of stipends to individuals who are invited to the conference based on the expectation that their participation and educational or professional background will enhance the conference may be treated as either a grant or a contract. If the Foundation benefits from their attendance at the conference in a significant way, such as from a written report of the discussion for ongoing use in developing Foundation initiatives, then the payment may be more appropriately is characterized as a contract.

EXAMPLE TWO

The Foundation offers fellowships to post-doctoral trainees to perform research and scholarly work in various scientific disciplines of interest to the Foundation's programmatic work. The fellowships are open to individuals across multiple scientific disciplines, and individuals must report on their research throughout the term of the fellowship. The Foundation expects all results to be published open access and receives a non-exclusive license to display summaries of research results or papers resulting from the funded fellowships. Such payments would generally constitute grants.

If, however, the Foundation provides additional funding to a fellow for research on a particular issue, intending to use the results of the research in evaluating its programs, and requires ownership of the resulting intellectual property rights with respect to the research, then the additional funding arrangement would more appropriately be characterized as a contract for services.

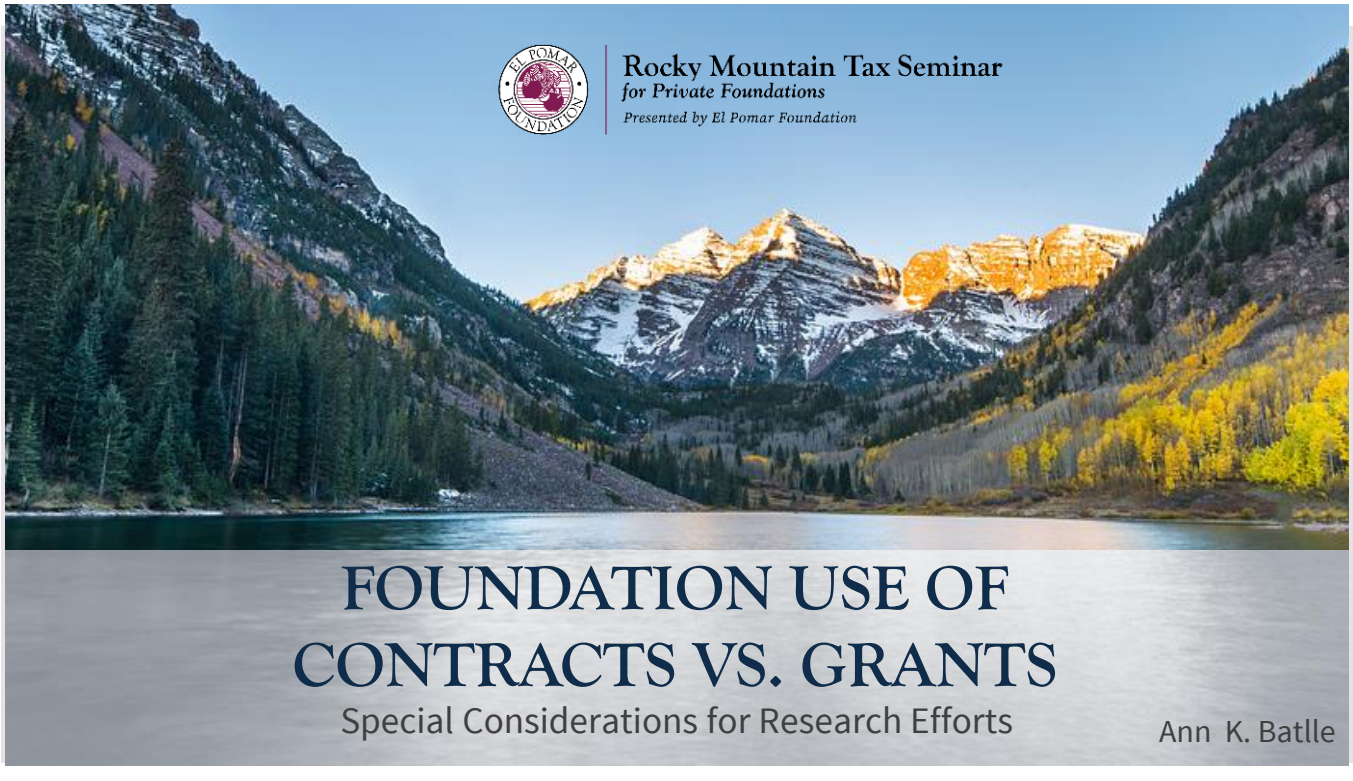
EXAMPLE THREE

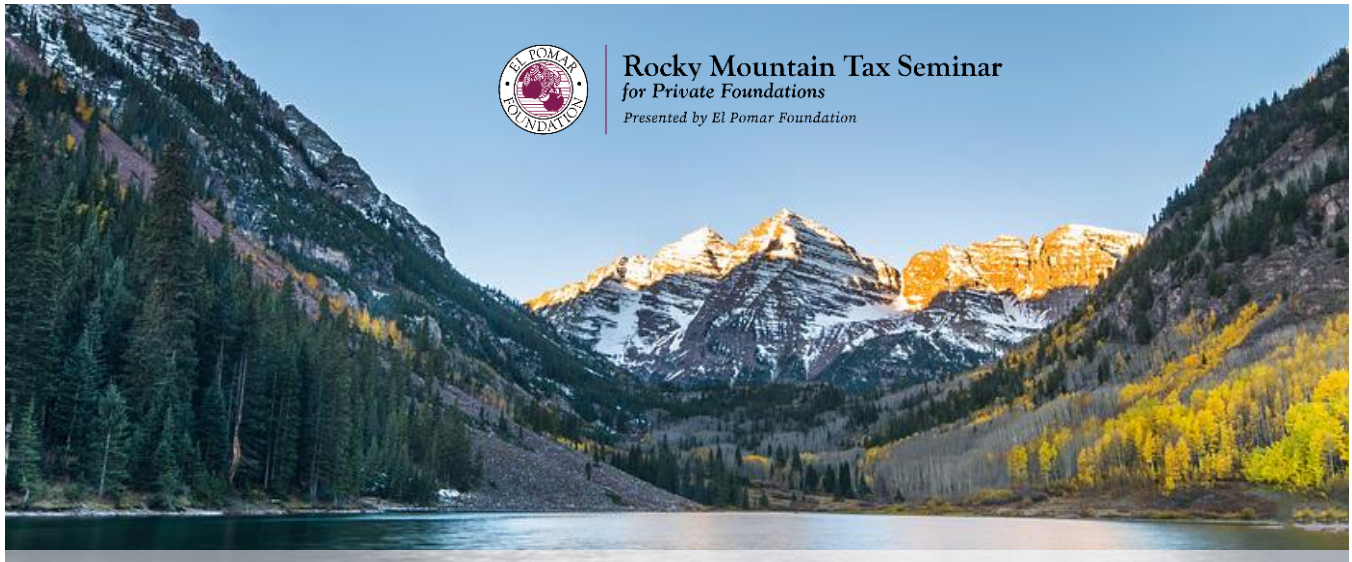
The Foundation funds a large-scale scientific collaboration across multiple university research sites. It pays a disease-focused research organization to assist in the design, development, and management of the Foundation-initiated collaboration that will focus on specified research projects. The organization identifies potential research sites to participate in the collaboration, provides evaluation and assessment services, and designs a database that will be owned by the Foundation through which the collaborators will share data and results with each other and, eventually the general public. Because the organization is assisting the Foundation in carrying out one of its initiatives, and the services are more appropriately characterized as for the benefit of the Foundation, the payment would constitute a contract.

EXAMPLE THREE (PART II)

Assume, however, that scientists at the same research organization have developed useful reagents or other materials that it will supply to each of the funded research sites and they have the specific technical expertise needed to support each site's appropriate use of the materials in the overall research effort. The Foundation will pay the research organization the usual costs of supplying the materials that it would have otherwise charged for each site's use. The Foundation will also provide research funding to the organization to support its participation as a scientific collaborator because of the expertise its scientists will contribute to the overall project.

The payments for material supplies could be characterized as a contract. But because the materials are necessary to the collaboration which will benefit the general public, and is made as part of funding to support the organization's overall participation in the project, the entire amount could be appropriately characterized as a grant.





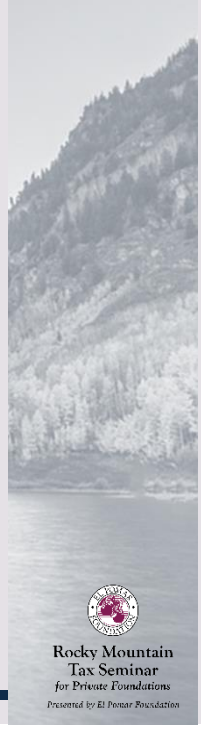
GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

September 15, 2023

JAMES K. HASSON, JR.
HASSON LAW GROUP, LLP

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **WHY WOULD ONE PRIVATE FOUNDATION WANT TO MAKE A GRANT OR TRANSFER TO ANOTHER PRIVATE FOUNDATION?**
  - OFTEN, TO PROVIDE EITHER OPERATING SUPPORT OR ENDOWMENT SUPPORT FOR A USE NOT WITHIN THE AREAS OF INTEREST OR COMPETENCE OF THE GRANTING FOUNDATION.
  - FREQUENTLY, TO RESOLVE DISAGREEMENTS AMONG DIRECTORS/TRUSTEES OR MEMBERS.



GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **WHY WOULD ONE PRIVATE FOUNDATION WANT TO MAKE A GRANT OR TRANSFER TO ANOTHER PRIVATE FOUNDATION?**
  - OCCASIONALLY, TO TERMINATE A PRIVATE FOUNDATION.
  - OCCASIONALLY, TO REORGANIZE A PRIVATE FOUNDATION UNDER NEW LEADERSHIP, IN A DIFFERENT JURISDICTION, IN A DIFFERENT FORM, OR FOR A NEW PURPOSE.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **DOES THE INTERNAL REVENUE CODE PERMIT A GRANT OR TRANSFER FROM ONE PRIVATE FOUNDATION TO ANOTHER PRIVATE FOUNDATION?**
  - SECTION 501(C)(3), OF COURSE, ADDRESSES THE ESSENTIAL ELEMENT THAT A GRANT OR TRANSFER BE FOR A CHARITABLE PURPOSE.
  - SECTION 4945 DIRECTLY ADDRESSES SUCH GRANTS OR TRANSFERS.
    - A GRANT OR TRANSFER TO A PRIVATE FOUNDATION WILL BE A "TAXABLE EXPENDITURE" UNLESS "EXPENDITURE RESPONSIBILITY" IS EXERCISED OVER THE GRANT OR TRANSFER.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **DOES THE INTERNAL REVENUE CODE PERMIT A GRANT OR TRANSFER FROM ONE PRIVATE FOUNDATION TO ANOTHER PRIVATE FOUNDATION?**

  - A TAXABLE EXPENDITURE CAN RESULT IN A PENALTY (CALLED AN "EXCISE TAX") ON THE FOUNDATION AND ON ITS MANAGERS, BASED ON THE AMOUNT OF THE EXPENDITURE.
  - ADDITIONAL TAXES APPLY IF EXPENDITURE IS NOT CORRECTED.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- EXPENDITURE RESPONSIBILITY INVOLVES FOUR ELEMENTS, NONE OF WHICH IS DIFFICULT TO ACCOMPLISH: A PRE-GRANT INQUIRY, A GRANT AGREEMENT, A REVIEW OF A REPORT FROM THE GRANTEE AND AN ATTEMPT TO RECOVER AN IMPROPERLY SPENT AMOUNT, AND A REPORT ON FORM 990-PF.

  - A GRANT FOR ENDOWMENT OR CAPITAL ASSET ACQUISITION NORMALLY NECESSITATES REPORTING BY THE GRANTEE FOR THREE YEARS.
  - A GRANT FOR OPERATING PURPOSES REQUIRES REPORTING BY THE GRANTEE UNTIL THE GRANT IS FULLY EXPENDED.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- SECTION 4942 ADDRESSES QUALIFYING DISTRIBUTIONS FOR PURPOSES OF THE MINIMUM ANNUAL DISTRIBUTION REQUIRED OF A PRIVATE FOUNDATION.
  - A QUALIFYING DISTRIBUTION DOES NOT INCLUDE:
    - A GRANT TO A CONTROLLED ORGANIZATION, TO A NON-OPERATING PRIVATE FOUNDATION, OR TO CERTAIN SUPPORTING ORGANIZATIONS;
    - EXCEPT WHERE THE GRANTEE "PASSES THROUGH" THE GRANT WITHIN A YEAR.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- CONSEQUENTLY, FOUNDATIONS NEEDING QUALIFYING DISTRIBUTIONS GENERALLY TRY TO AVOID GRANTS TO A NON-OPERATING PRIVATE FOUNDATION, AS WELL AS TO CONTROLLED ORGANIZATIONS OR DISFAVORED SUPPORTING ORGANIZATIONS.

- SECTIONS 4941 (SELF-DEALING) AND 4944 (JEOPARDIZING INVESTMENTS) SHOULD NOT BE A CONCERN IN THE USUAL CASE.

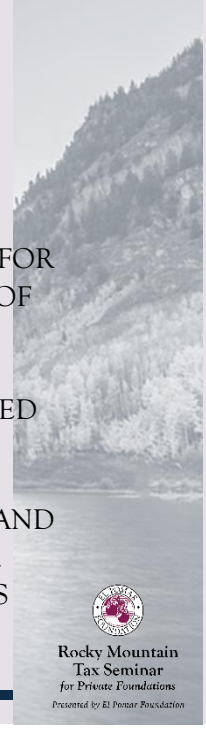
- SECTION 4943 CAN HAVE AN EFFECT ON CERTAIN CHARACTERISTICS RELEVANT FOR EXCESS BUSINESS HOLDINGS PURPOSES.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- SECTION 507(B)(2) ADDRESSES DIVISIVE, TERMINATING OR REORGANIZING TRANSFERS.
  - SECTION 507's PRINCIPAL PURPOSE IS TO IMPOSE A HUGE TAX ON A FOUNDATION THAT "TERMINATES" VOLUNTARILY WHILE HAVING ASSETS OR BECAUSE OF REPEATED OR FLAGRANT ACTS SUBJECT TO PENALTY.
  - SECTION 507 EXTENDS BEYOND TERMINATION, HOWEVER.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- SECTION 507(B)(1) PROVIDES AN EASY ESCAPE: TRANSFER ALL ASSETS TO A PUBLIC CHARITY OF CERTAIN TYPES.
  - HOWEVER, THE REGULATIONS DO CONTAIN AN UNEXPECTED "TRAP FOR THE UNWARY": IF A PRIVATE FOUNDATION TRANSFERS ALL OR PART OF ITS ASSETS TO A PUBLIC CHARITY AND THE TRANSFEREE LOSES ITS PUBLIC CHARITY STATUS AND BECOMES A PRIVATE FOUNDATION WITHIN THREE YEARS OF TRANSFER, THE INITIAL TRANSFER IS TREATED AS IF IT WERE MADE TO A PRIVATE FOUNDATION.
  - THIS REQUIREMENT POSES A DILEMMA FOR BOTH THE TRANSFEROR AND TRANSFEREE, ESPECIALLY IF A TRANSFER OF ALL ASSETS IS INVOLVED. TYPICALLY, NEITHER THE TRANSFEROR NOR THE TRANSFEREE WANTS TO TAKE ALL THE ACTIONS FOR A FOUNDATION-TO-FOUNDATION TRANSFER.



GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- THE STATUTORY LANGUAGE OF SECTION 507(B)(2) CRYPTICALLY ADDRESSES A TRANSFER TO ANOTHER FOUNDATION "PURSUANT TO ANY LIQUIDATION, MERGER, REDEMPTION, RECAPITALIZATION, OR OTHER ADJUSTMENT, OR REORGANIZATION."

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **MORE DETAILS ABOUT FOUNDATION-TO-FOUNDATION TRANSFERS UNDER SECTION 507(B)(2).**
  - REGULATIONS LIMIT APPLICATION OF SECTION 507(B)(2) TO THREE SITUATIONS:
    - LIQUIDATION, MERGER, REDEMPTION, RECAPITALIZATION, OR OTHER ADJUSTMENT, ORGANIZATION OR REORGANIZATION, WITH THE LATTER TWO TERMS DEFINED BY REFERENCE TO BUSINESS ORGANIZATION MERGERS, CONSOLIDATIONS, OR CHANGES IN IDENTITY, FORM OR PLACE OF ORGANIZATION.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **MORE DETAILS ABOUT FOUNDATION-TO-FOUNDATION TRANSFERS UNDER SECTION 507(B)(2).**
  - PARTIAL LIQUIDATION (UNDEFINED BUT POSSIBLY REFERRING TO CODE SECTION 302(E) AS THE CESSATION OF SOME, BUT NOT ALL, CORPORATE ACTIVITIES).
  - RELATED DISPOSITIONS FROM CORPUS AGGREGATING 25% OR MORE OF TRANSFERRING FOUNDATION'S ASSET VALUE.
    - SECTION 507(B)(2) OVERRIDES SECTIONS 4945 AND 4942 TO A LIMITED EXTENT, DISCUSSED BELOW.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **HOW DO THESE DIFFERENT CODE SECTIONS COME TOGETHER IN SPECIFIC SITUATIONS?**
  - AN OPERATING OR ENDOWMENT GRANT OF A PORTION OF ASSETS:
    - TO A PRIVATE OPERATING FOUNDATION.
      - SECTION 4942 DOES NOT DENY QUALIFYING DISTRIBUTION CREDIT FOR A GRANT TO A NON-CONTROLLED PRIVATE OPERATING FOUNDATION.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **HOW DO THESE DIFFERENT CODE SECTIONS COME TOGETHER IN SPECIFIC SITUATIONS?**
  - SECTION 507(B)(2) DOES NOT APPLY TO A GRANT OR TRANSFER OF 25% OR LESS OF NET VALUE (UNLESS PARTIAL LIQUIDATION RULE APPLIES).
  - SECTION 4945 CAN BE SATISFIED BY THE TRANSFEROR'S EXERCISE OF EXPENDITURE RESPONSIBILITY.
  - CONSEQUENTLY, SUCH A GRANT FOR EITHER OPERATING OR ENDOWMENT/ CAPITAL PURPOSES SHOULD BE OK.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **HOW DO THESE DIFFERENT CODE SECTIONS COME TOGETHER IN SPECIFIC SITUATIONS?**
  - TO A PRIVATE NON-OPERATING FOUNDATION OF A PORTION OF ASSETS:
    - A GRANT TO A NON-OPERATING FOUNDATION CAN BE A QUALIFYING DISTRIBUTION IF THE "PASS THROUGH" RULES ARE FOLLOWED.
    - AS ABOVE, SECTION 507(B)(2) DOES NOT APPLY TO AN INSUBSTANTIAL, NON-LIQUIDATING TRANSFER.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **HOW DO THESE DIFFERENT CODE SECTIONS COME TOGETHER IN SPECIFIC SITUATIONS?**
  - AS ABOVE, SECTION 4945 CAN BE SATISFIED BY THE EXERCISE OF EXPENDITURE RESPONSIBILITY.
  - CONSEQUENTLY, A GRANT TO A PRIVATE NON-OPERATING FOUNDATION FOR A ONE-YEAR OPERATING EXPENDITURE OR CHARITABLE-USE ASSET PURCHASE SHOULD NOT BE A TAXABLE EXPENDITURE AND SHOULD BE A QUALIFYING DISTRIBUTION, BUT THE SAME IS NOT SO FOR AN ENDOWMENT OR OTHER MULTI-YEAR GRANT.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **HOW DO THESE DIFFERENT CODE SECTIONS COME TOGETHER IN SPECIFIC SITUATIONS?**
  - A TERMINATING OR REORGANIZING TRANSFER.
    - IN REV. RUL. 2002-28, IRS RULED PUBLICLY THAT NO EXPENDITURE RESPONSIBILITY WAS REQUIRED FOR THE TRANSFER FROM ONE PRIVATE FOUNDATION OF ALL OF ITS ASSETS TO AN EFFECTIVELY CONTROLLED PRIVATE FOUNDATION. THEN, IN REV. RUL. 2008-41, IRS SAID THE SAME RULE APPLIED IF THE TRANSFER WAS TO A NON-CONTROLLED PRIVATE FOUNDATION.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

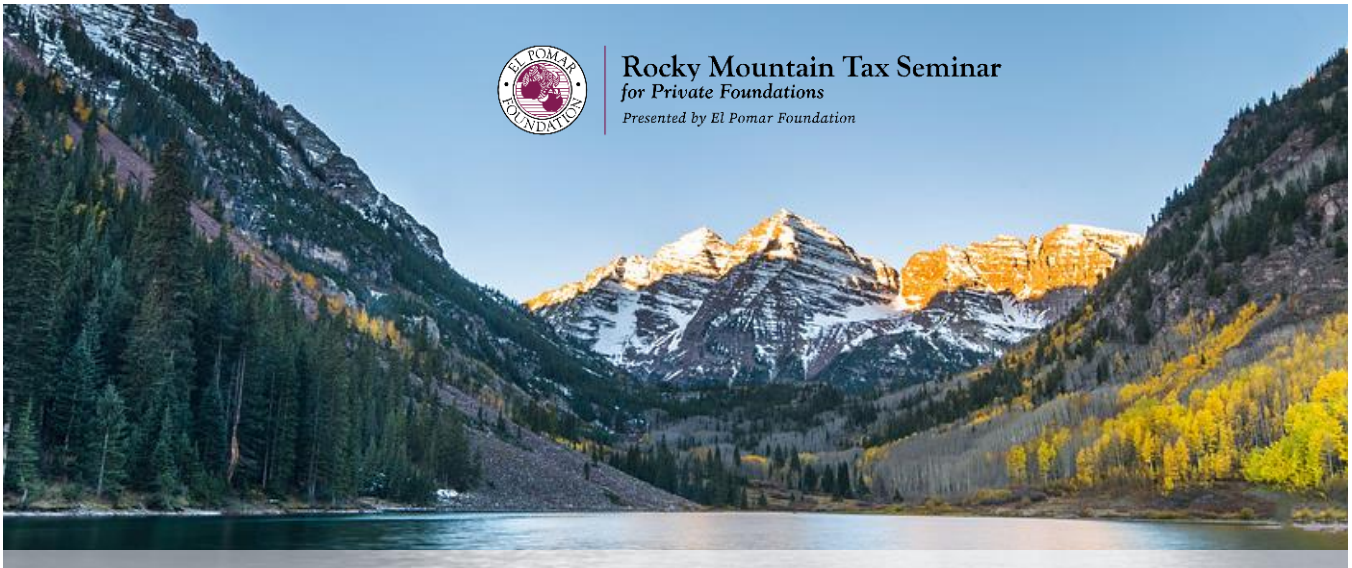
- **HOW DO THESE DIFFERENT CODE SECTIONS COME TOGETHER IN SPECIFIC SITUATIONS?**
  - IN RECENT PRIVATE RULINGS, THE IRS HAS DISTINGUISHED THE EXPENDITURE RESPONSIBILITY REQUIREMENT BASED ON WHETHER THE TRANSFER WAS OF 100% OF A FOUNDATION'S ASSETS OR LESS THAN 100%. THE IRS RULED THAT NO EXPENDITURE RESPONSIBILITY IS REQUIRED FOR A 100% TRANSFER BUT IS REQUIRED FOR ANY TRANSFER OF LESS THAN 100% OF NET ASSETS. SEE, E.G., PLR 202231008 (80% TRANSFER) AND PLR 201606030 (100% TRANSFER), IN BOTH ASSUMING THAT TRANSFEROR AND TRANSFEREE WERE EFFECTIVELY CONTROLLED.

GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **HOW DO THESE DIFFERENT CODE SECTIONS COME TOGETHER IN SPECIFIC SITUATIONS?**
  - A DIVISIVE TRANSFER THAT IS A PARTIAL LIQUIDATION OR TRANSFER OF 25% OR MORE OF ASSET VALUE.
    - IN PLR 201335019, THE IRS PRIVATELY RULED THAT AN ENDOWMENT GRANT OF LESS THAN 25% OF A FOUNDATION'S NET ASSET VALUE TO ANOTHER PRIVATE FOUNDATION COULD AVOID A TAXABLE EXPENDITURE PENALTY THROUGH THE EXERCISE OF EXPENDITURE RESPONSIBILITY.

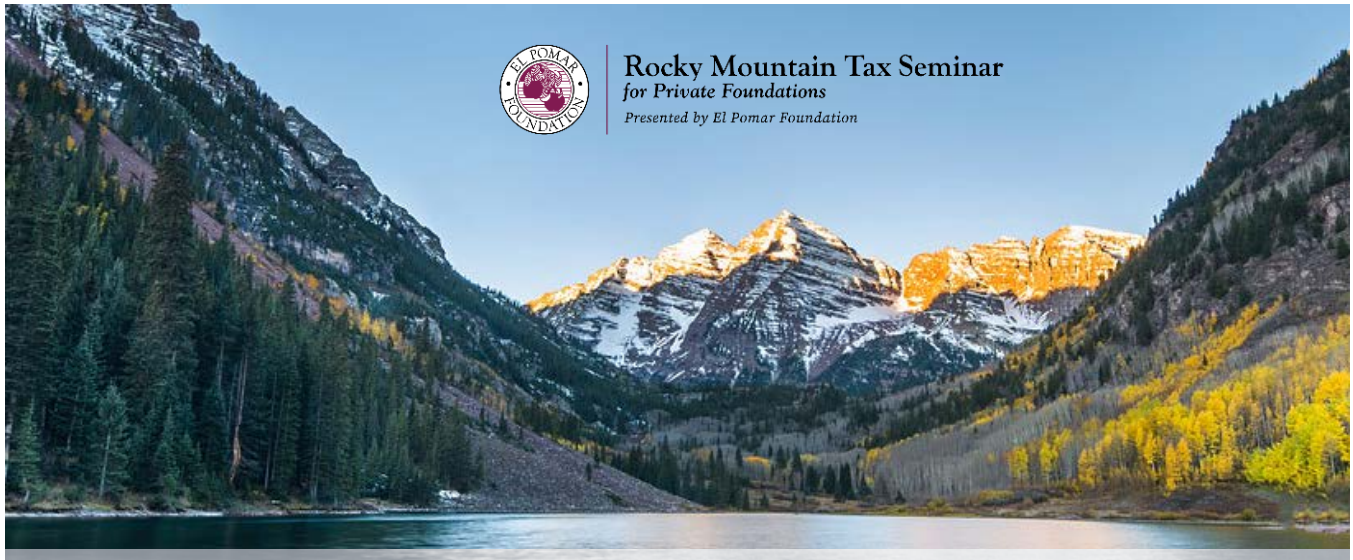
GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

- **HOW DO THESE DIFFERENT CODE SECTIONS COME TOGETHER IN SPECIFIC SITUATIONS?**
  - IRS RULINGS RARELY ADDRESS THE MINIMUM DISTRIBUTION CONSEQUENCES OF A TRANSFER OF MORE THAN 25% BUT LESS THAN 100% OF ASSETS TO A NON-CONTROLLED FOUNDATION. THE APPARENT RESULTS SHOULD BE THAT SUCH A TRANSFER TO A NON-CONTROLLED OPERATING FOUNDATION DOES NOT REQUIRE A ONE-YEAR "PASS THROUGH" BUT THAT A TRANSFER OF BETWEEN 25% AND 100% TO A NON-CONTROLLED NON-OPERATING FOUNDATION DOES REQUIRE A "PASS THROUGH."



GRANTS AND TRANSFERS TO OTHER FOUNDATIONS

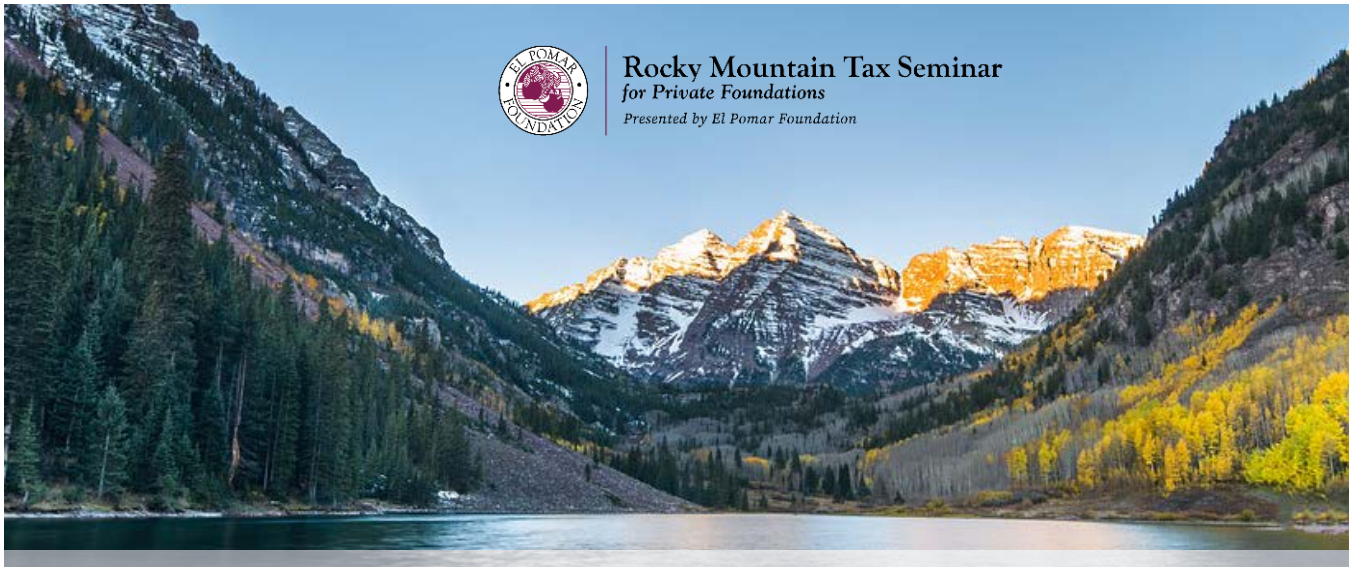
September 15, 2023
JAMES K. HASSON, JR.
HASSON LAW GROUP, LLP



GLAM, TEOS & EO BMF Extract: How Treasury & IRS Communicate about EO Laws & EOs

Ruth Madrigal, KPMG LLP

September 15, 2023



EO Epistemology: What do we know? How do we know it?

NOTICE

The following information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

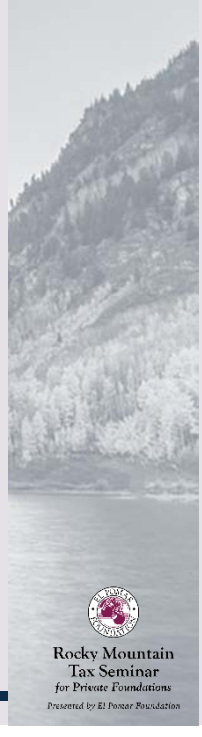
The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

ON KNOWING....

To know that we know what we know, and that we do not know what we do not know, that is true knowledge.
— Confucius, 551-479 BC

Those who know do not speak; those who speak do not know.
— Lao-Tzu, 6th cent. BC

The next best thing to knowing something is knowing where to find it.
— Samuel Johnson, 1709-1784



AGENDA

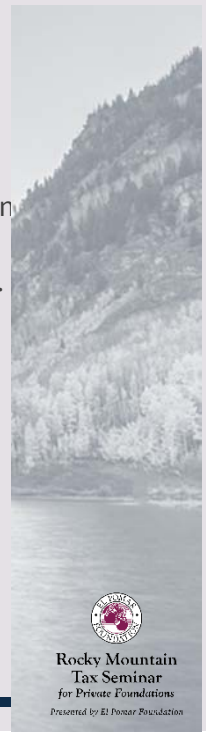
- IRS/Treasury sources of information about the EO Laws
  - Published Guidance
  - Unpublished Guidance
  - Administrative materials
- IRS information about EOs
  - TEOS & BMF

IRS/Treasury sources of information about the EO Laws

AGENDA

Published Guidance
(aka Guidance Of General Applicability)

1. **Regulations** published in the Federal Register:
    - *Chevron* deference: Courts will generally defer to IRS's reasonable interpretation of an ambiguous statute
    - Notice-and-comment required for legislative rules (that carry the force of law).
2. **Sub-regulatory guidance** published in the Internal Revenue Bulletin
    - Includes Revenue Rulings, Revenue Procedures, Notices, Announcements
    - Rev. Proc. 89-14 ("Taxpayers generally may rely upon revenue rulings and revenue procedures. . . in determining the tax treatment of their own transactions.")
    - "Taxpayers can have confidence . . . that the IRS will not take positions inconsistent with its subregulatory guidance when such guidance is in effect." Treasury's Policy Statement on the Tax Regulatory Process (Mar. 5, 2019)



Subregulatory Guidance – Tier I

- **Revenue Ruling**

A revenue ruling is an official interpretation by the Service of the Internal Revenue Code, related statutes, tax treaties, and regulations. It is the conclusion of the Service on how the law is applied to a specific set of facts.

- **Revenue Procedure**

A revenue procedure is an official statement of a procedure by the Service that affects the rights or duties of taxpayers or other members of the public under the Internal Revenue Code, related statutes, tax treaties, and regulations, or information that, although not necessarily affecting the rights and duties of the public, should be a matter of public knowledge.

Subregulatory Guidance – Tier II

- **Notice**

A notice is a public pronouncement by the Service that may contain guidance that involves substantive interpretations of the Internal Revenue Code or other provisions the law. . . . [N]otices may be used to solicit public comments on issues under consideration, in connection with non-regulatory guidance, such as a proposed revenue procedure. A notice also can be used to relate what regulations will say in situations in which the regulations may not be published in the immediate future.

- **Announcement**

An announcement is a public pronouncement that has only immediate or short-term value. For example, an announcement can be used to summarize the law or regulatio without making any substantive interpretation or to notify taxpayers of the existence an election or an approaching deadline for making an election.

Effect of Subregulatory Guidance

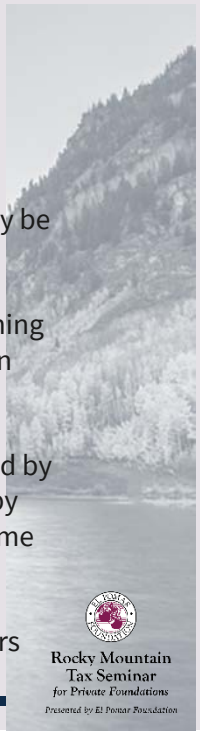
IRM 32.2.2.10 (08-11-2004)
Force and Effect of Revenue Rulings, Revenue Procedures, Notices, Announcements, and News Releases

1. Revenue rulings provide precedents to be used in the disposition of other cases and may be cited and relied upon for that purpose. See Rev. Proc. 89–14, 1989–1 C.B. 814.

2. Taxpayers generally may rely upon revenue rulings and revenue procedures in determining their tax treatment if their facts and circumstances are substantially the same as those in the revenue ruling or revenue procedure. See Rev. Proc. 89–14.

3. For [certain understatement penalty] purposes…, all notices and announcements issued by the Service and published in the IRB are considered authority and the Service is bound by the substantive or procedural guidance provided in a notice or announcement to the same extent as a revenue ruling or revenue procedure. See Rev. Rul. 90–91, 1990–2 C.B. 262.

4. Chief Counsel attorneys must follow legal positions established by publications in papers filed in Tax Court....

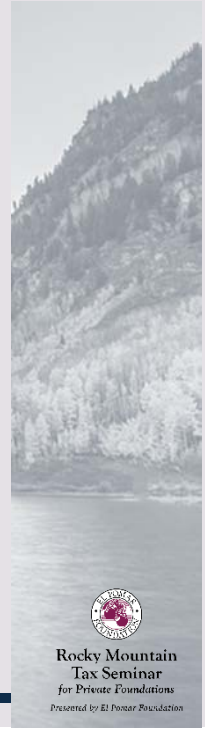


Effect of Subregulatory Guidance

Subregulatory guidance is not intended to affect taxpayer rights or obligations independent from underlying statutes or regulations. Unlike statutes and regulations, subregulatory guidance does not have the force and effect of law. Taxpayers can have confidence, however, that the IRS will not take positions inconsistent with its subregulatory guidance when such guidance is in effect. In applying subregulatory guidance, the effect of subsequent legislation, court decisions, rulings, and procedures must be considered.

When proper limits are observed, subregulatory guidance can provide taxpayers the certainty required to make informed decisions about their tax obligations. Such guidance cannot and should not, however, be used to modify existing legislative rules or create new legislative rules. The Treasury Department and the IRS will adhere to these limits and will not argue that subregulatory guidance has the force and effect of law.

-- Treasury's Policy Statement on the Tax Regulatory Process (Mar. 5, 2019)



"Unpublished" Guidance

"Unpublished" guidance must be released to the press/public . . . who publish it…

§ 6110 - Public inspection of written determinations

(a) General rule

Except as otherwise provided in this section, the text of any written determination and any background file document relating to such written determination shall be open to public inspection at such place as the Secretary may by regulations prescribe.

(b)(1) Written determination

(A) In general

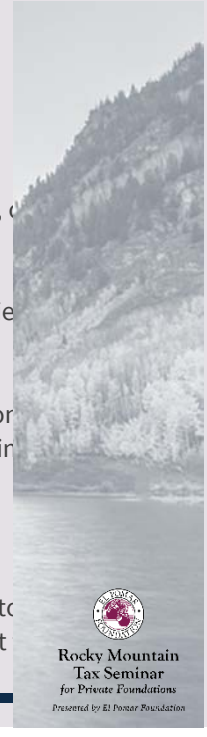
The term "written determination" means a ruling, determination letter, technical advice memorandum, or Chief Counsel advice.

- Generally, unpublished guidance may not be relied upon or cited as precedent. Taxpayer-requested guidance may not be relied upon or cited as precedent except by the taxpayer to which it is issued. See IRC § 6110(k)(3).

"Unpublished" Guidance

Some unpublished guidance is issued in response to taxpayer requests, including:

- **"Determination letters"** – issued by the IRS Exempt Organizations Determinations office in response to a request for the IRS's ruling on a question of tax-exempt status, foundation status, o other determination under their jurisdiction. *See* Rev. Rul. 2023-5.
- **Private letter rulings (PLRs)** – written determinations issued to a taxpayer by an Associate Chie Counsel office in response to the taxpayer's written inquiry. *See* Rev. Rul. 2023-1
- **Technical advice memoranda (TAMs)** – furnished by an Associate Chief Counsel office in respor to a request for assistance on a technical or procedural question that develops during a precedir before the IRS (e.g., an exam). *See* Rev. Rul. 2023-2.
  - May also be requested by IRS exam agent or Appeals officer
- **Information letters** – a statement issued by an Associate office or Director that calls attention to well-established interpretation or principle of tax law (including a tax treaty) without applying it specific set of facts. *See* Rev. Rul. 2023-1.



"Unpublished" Guidance

"**Chief Counsel Advice (CCA)** – an umbrella term for legal advice prepared by any National Office component of Chief Counsel or division counsel and issued to field or service center employees of the IRS or Chief Counsel. It "is a term used to describe a certain subset of legal advice that is required to be released to the public under IRC 6110. Not all legal advice is subject to this public disclosure requirement." (IRM 33.1.2)

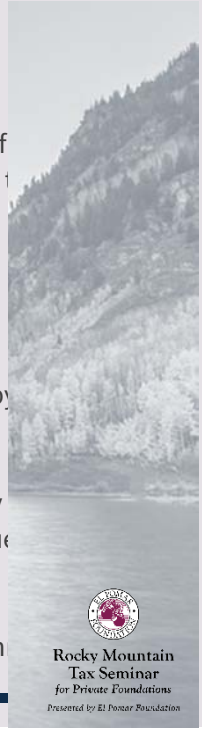
- **Program Manager Technical Advice (PMTA)** – legal advice issued by Associate Chief Counsel to IRS personnel who are national program executives and managers
- **Field advice reviewed by the national office (FARBNO)** – Legal advice prepared in the field and reviewed by Associate Chief Counsel
- **Generic Legal Advice Memorandum (GLAM)** – internal IRS legal advice issued by the Office of Chief Counsel to assist IRS service personnel in administering their duties

"Unpublished" Guidance

Chief Counsel Advice (CCA) – an umbrella term for legal advice prepared by any National Office component of Chief Counsel or division counsel and issued to field or service center employees of IRS or Chief Counsel. It "is a term used to describe a certain subset of legal advice that is required t be released to the public under IRC 6110. Not all legal advice is subject to this public disclosure requirement." (IRM 33.1.2)

From the IRS website:

- **Field advice reviewed by the national office (FARBNO)**: These documents are prepared by field attorneys in the Office of Chief Counsel, reviewed by an Associate Office, and subsequently issued to field or service center campus employees of the IRS.
- **Program Manager Technical Advice (PMTA)**: These documents are legal advice, signed by attorneys in the National Office of the Office of Chief Counsel and issued to Internal Revenue Service personnel who are national program executives and managers.
- **Generic Legal Advice Memorandum (GLAM)**: Legal advice, signed by executives in the National Office of the Office of Chief Counsel and issued to Internal Revenue Service person who are national program executives and managers.



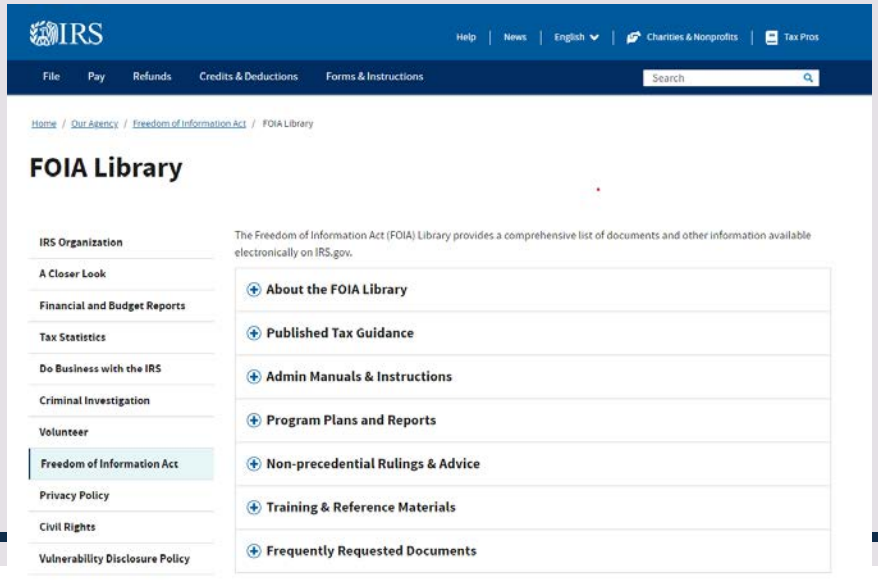
"Unpublished" Guidance

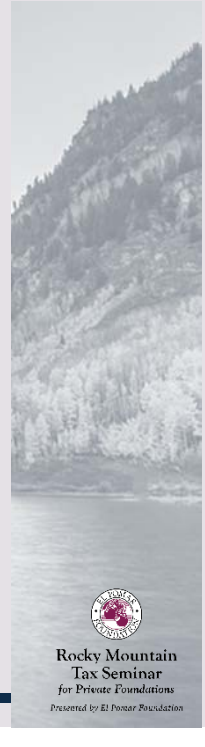
"Other "CCA"

- **General Counsel Memoranda (GCMs) –** formerly the way the Office of Chief Counsel communicated legal advice in the context of PLRs and revenue rulings to the IRS assistant commissioner (technical)

- **Field Service Advice (FSA)** – case specific advice provided to examiners, attorneys, and appeals officers that was provided by Associate Chief Counsel

Where to Find Published (and Unpublished) IRS Guidance



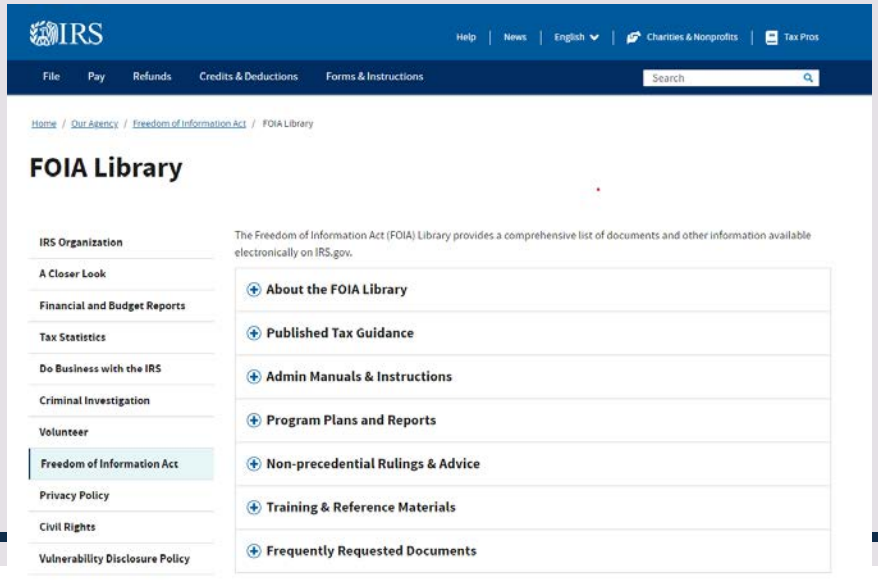


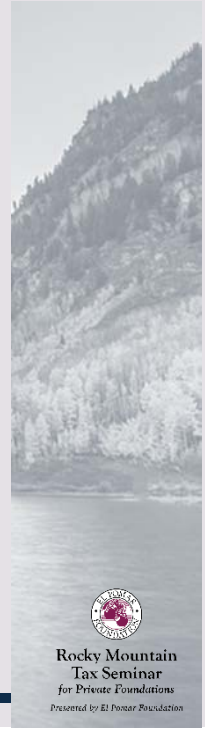
Where to Find Published (and Unpublished) IRS Guidance

Published Tax Guidance

- Advance Releases
  Early distribution of some IRB materials before they are published in the IRB.
- Applicable Federal Rate (AFR) Revenue Rulings
- Final or Temporary Regulations (Treasury Decisions) and Proposed Regulations
- IRS Publications & Notices
- Internal Revenue Bulletins (IRB)
  Weekly compilations of Revenue Rulings, Revenue Procedures, Announcements, and Notices.
  - PDF format (1996 to present)
  - HTML format (July 7, 2003 to present)

Where to Find Published (and Unpublished) IRS Guidance





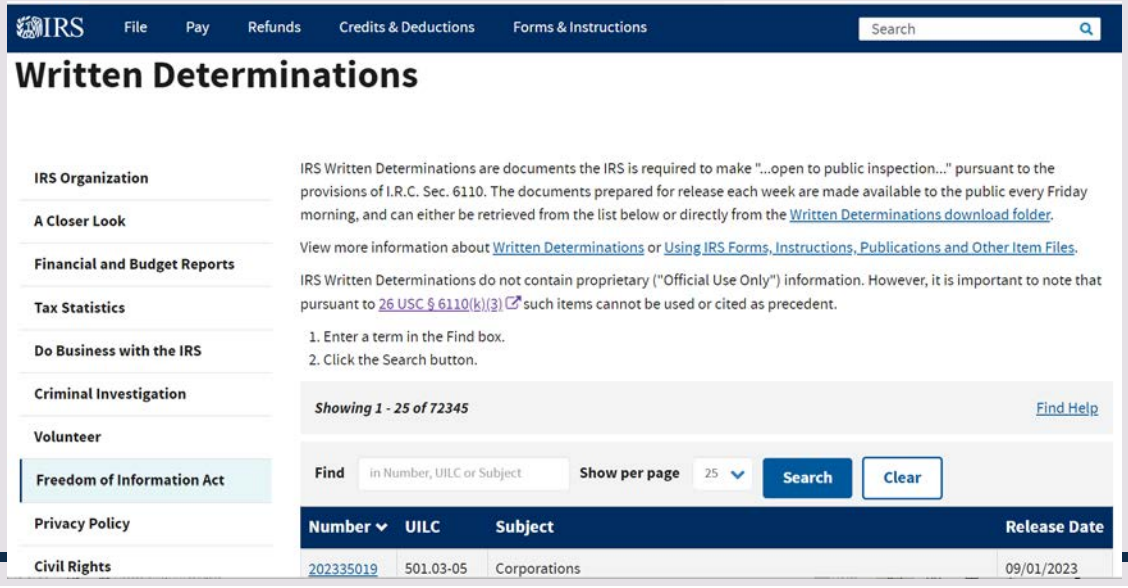
Where to Find Published (and Unpublished) IRS Guidance

Non-precedential Rulings & Advice

- Actions on Decisions (AOD)
- Appeals Settlement Guidelines
- Chief Counsel Bulletins
- Information Letters
- IRS Written Determinations
  Private Letter Rulings (PLR), Technical Advice Memorandum (TAM), and Chief Counsel Advice (CCA).
- Legal Advice Issued by Associate Chief Counsel
- Legal Advice Issued by Field Attorneys
- Legal Advice Issued to Program Managers

Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Ponar Foundation

Where to Find Published (and Unpublished) IRS Guidance



Rocky Mountain Tax Seminar
for Private Foundations
Presented by El Ponar Foundation

Where to Find Published (and Unpublished) IRS Guidance

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Number	UILC	Subject	Release Date
202302012	170.12-09	Substantiation	01/13/2023
202236010	170.00-00	Charitable, Etc. Contributions and Gifts	09/09/2022
202141022	170.14-00	Qualified Conservation Contribution	10/15/2021
202130014	170.14-03	Conservation Purpose	07/30/2021
202047005	170.00-00	Charitable, Etc. Contributions and Gifts	11/20/2020
202027003	170.00-00	Charitable, Etc. Contributions and Gifts	07/02/2020
202020002	170.14-00	Qualified Conservation Contribution	05/15/2020
202002011	170.00-00	Charitable, Etc. Contributions and Gifts	01/10/2020
202002011	170.14-00	Qualified Conservation Contribution	01/10/2020
201952009	170.07-06	Publicly Supported Organizations	12/27/2019

Where to Find Published (and Unpublished) IRS Guidance

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **202302012**
Release Date: 1/13/2023

CC:ITA:B02
POSTN-114643-22

UILC: 170.12-09

date: January 10, 2023

to: Michael R. Fiore
Area Counsel, 1 (Boston)
(Small Business/Self-Employed)

from: Ronald J. Goldstein
Senior Technician Reviewer, Branch 2
(Income Tax & Accounting)

subject: Qualified appraisal requirement for charitable contributions of cryptocurrency

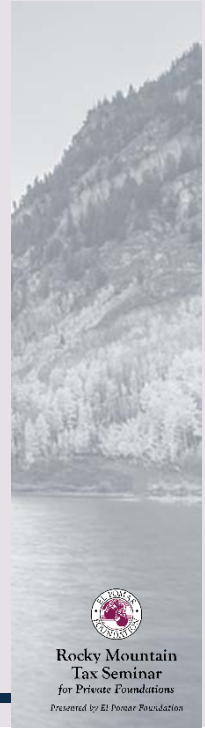
Where to Find Published (and Unpublished) IRS Guidance

Admin Manuals & Instructions

- Appeals Coordinated Issues (ACI)
- Chief Counsel (CC) Notices
- Internal Revenue Manual (IRM)
  - Recent Del Orders/Policy Statements
  - Recent Interim Guidance to Staff
- LB&I Industry Director Guidance
- LBI Compliance Priorities Guidance Memo PDF
- SBSE All-Collection Guidance Memo PDF
- SBSE Collection Guidance Memo PDF
- SBSE Examination Guidance Memo PDF
- SBSE Field Collection Guidance Memo PDF
- SBSE Field Exam and Campus Policy Guidance Memo PDF
- SBSE Specialty Exam and Policy Guidance Memo PDF
- Summons Memo PDF
- Taxpayer Advocate Service Level Agreements
- Tax Exempt and Government Entities Directives
- Freedom of Information Act Obligations and Transparency Memo PDF

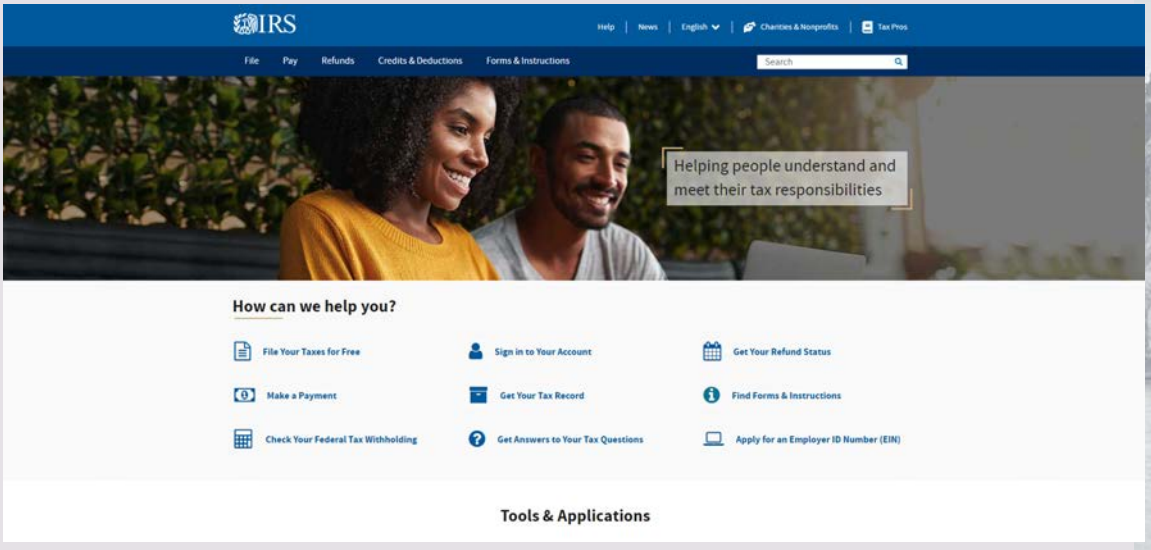
IRS Guidance for Revenue Agents

- Audit Technique Guides and Technical Guides (https://www.irs.gov/charities-non-profits/audit-technique-guides-atgs-and-technical-guides-tgs-for-exempt-organizations) are prepared by the IRS to help IRS agents work cases
- "Issue snapshots" (https://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots) are employee job aids that provide analysis and resources for a given technical tax issue
- The Exempt Organizations Continuing Professional Education Technical Instruction Program – also known as the EO CPE text – used to provide an annual technical update for IRS Exempt Organizations revenue agents and tax law specialists (still available at https://www.irs.gov/pub/irs-tege/cpeindexbytopic.pdf)
- Internal Revenue Manual (IRM) (https://www.irs.gov/irm) contains instructions and guidelines relating to the organization, functions, administration, and operations of the IRS.



IRS information about EOs

Tax-Exempt Organization Search



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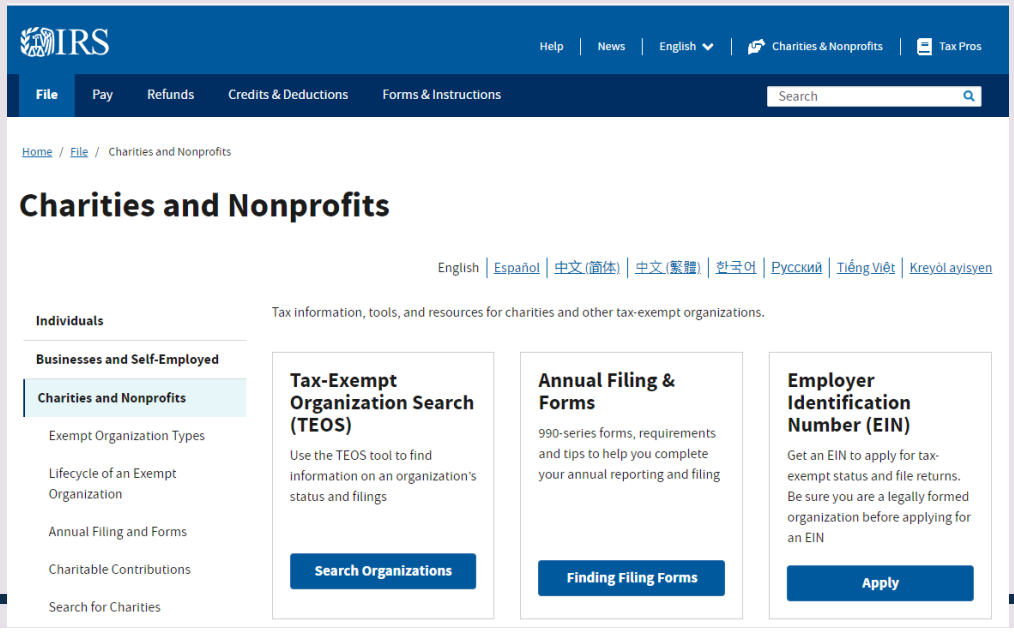

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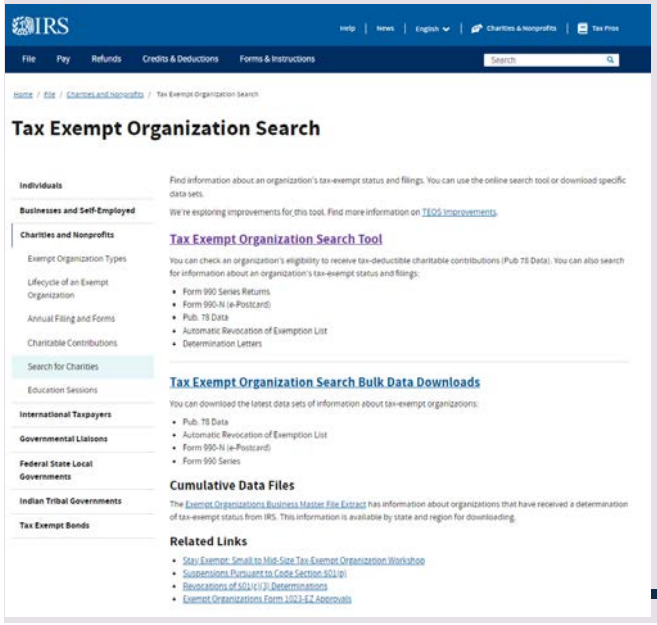
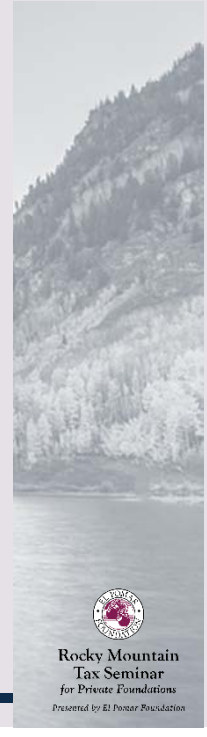


On the IRS website you can find access information about individual EOs in the TEOS tool.

Data sets containing information about large numbers of EOs can also be downloaded.



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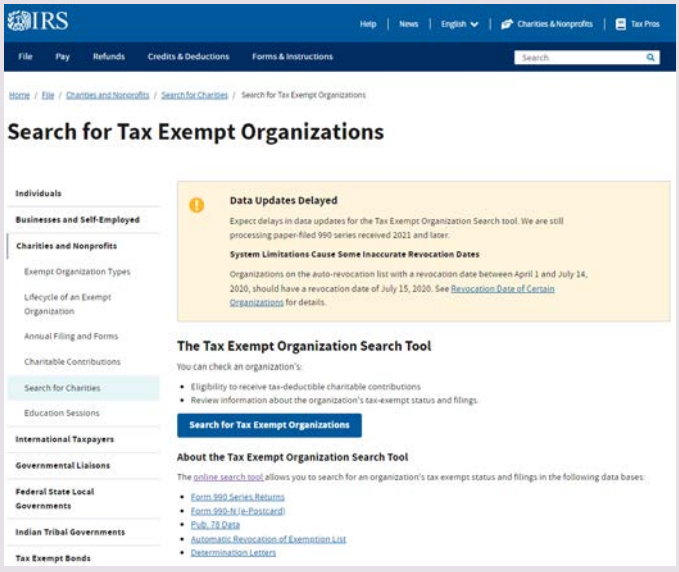
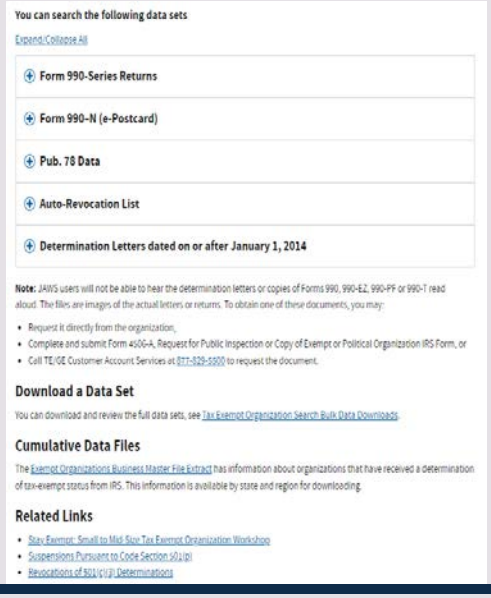
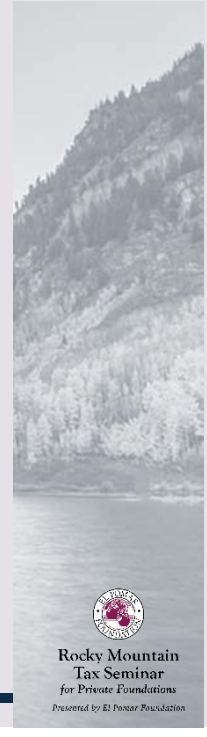


Click the blue button to access TEOS to search five data bases for EO information.

Tax-Exempt Organization Search



Further down that page, there is information about the data sets, including the date of the latest data posting.



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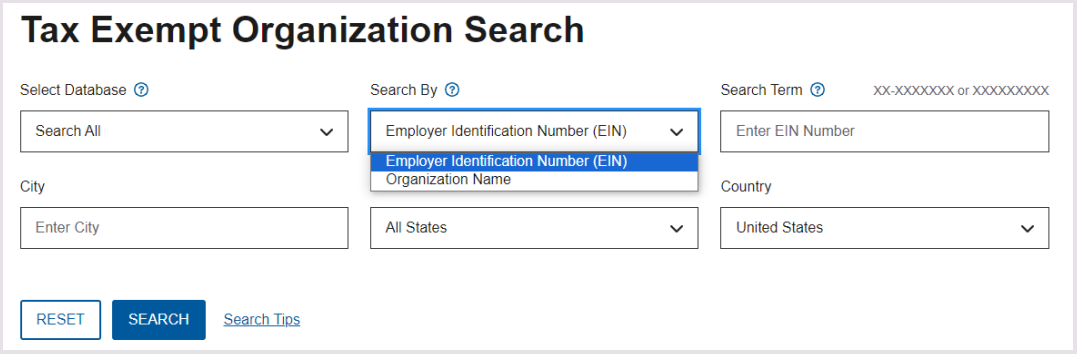
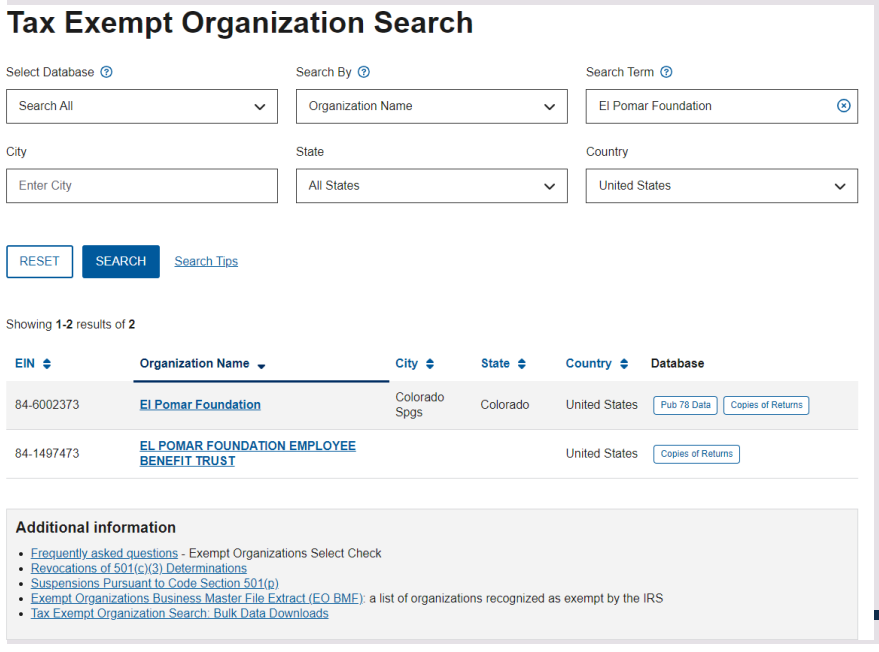
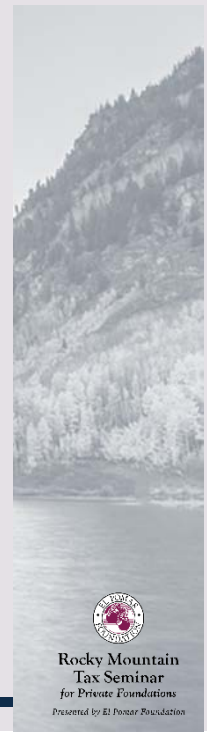


Search for an EO by name, EIN, city, state or a combination.

Tax-Exempt Organization Search



Information for the EO is accessed by clicking on the name of the organization or the data base buttons.



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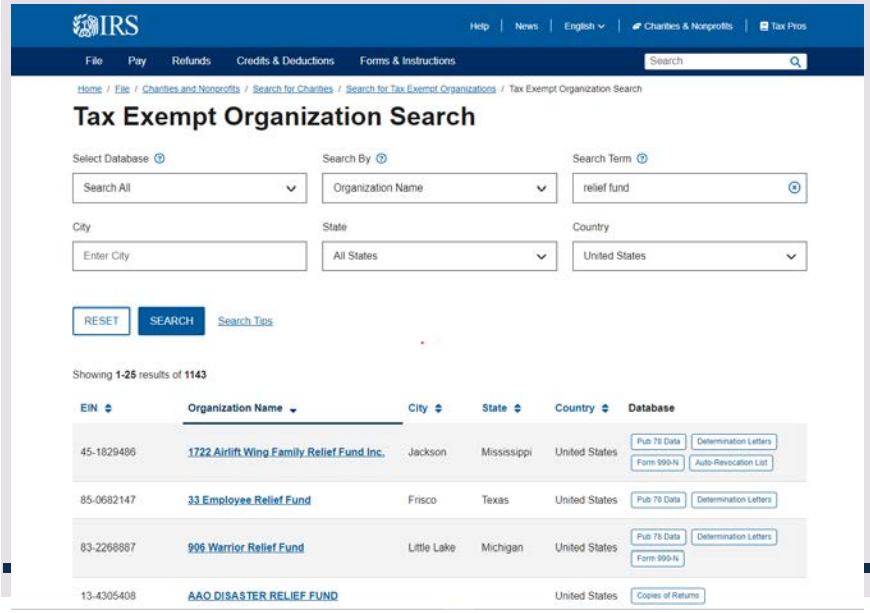

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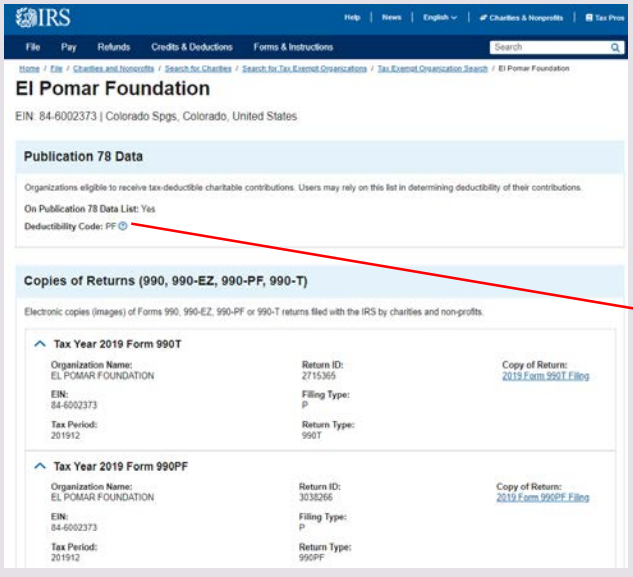
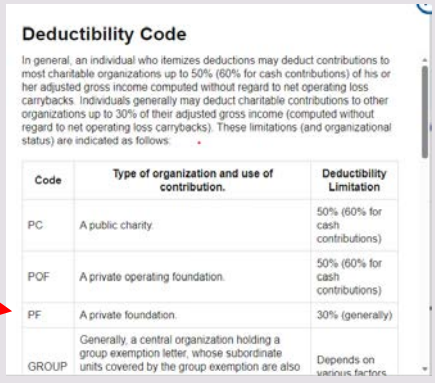
Tax-Exempt Organization Search

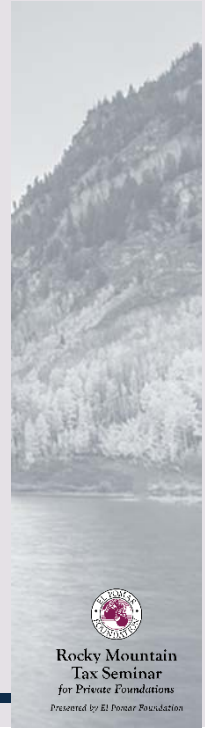




Deductibility Code

In general, an individual who itemizes deductions may deduct contributions to most charitable organizations up to 50% (60% for cash contributions) of his or her adjusted gross income computed without regard to net operating loss carrybacks. Individuals generally may deduct charitable contributions to other organizations up to 30% of their adjusted gross income (computed without regard to net operating loss carrybacks). These limitations (and organizational status) are indicated as follows:

Code	Type of organization and use of contribution.	Deductibility Limitation
PC	A public charity.	50% (60% for cash contributions)
POF	A private operating foundation.	50% (60% for cash contributions)
PF	A private foundation.	30% (generally)
GROUP	Generally, a central organization holding a group exemption letter, whose subordinate units covered by the group exemption are also	Depends on various factors



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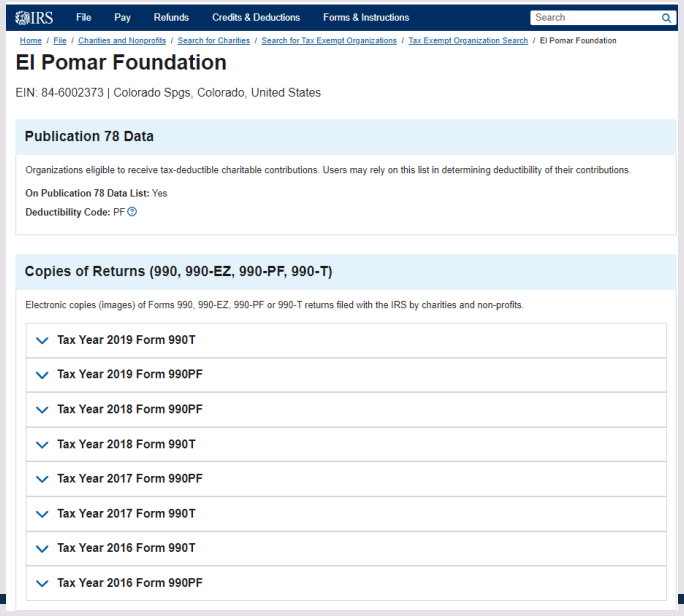
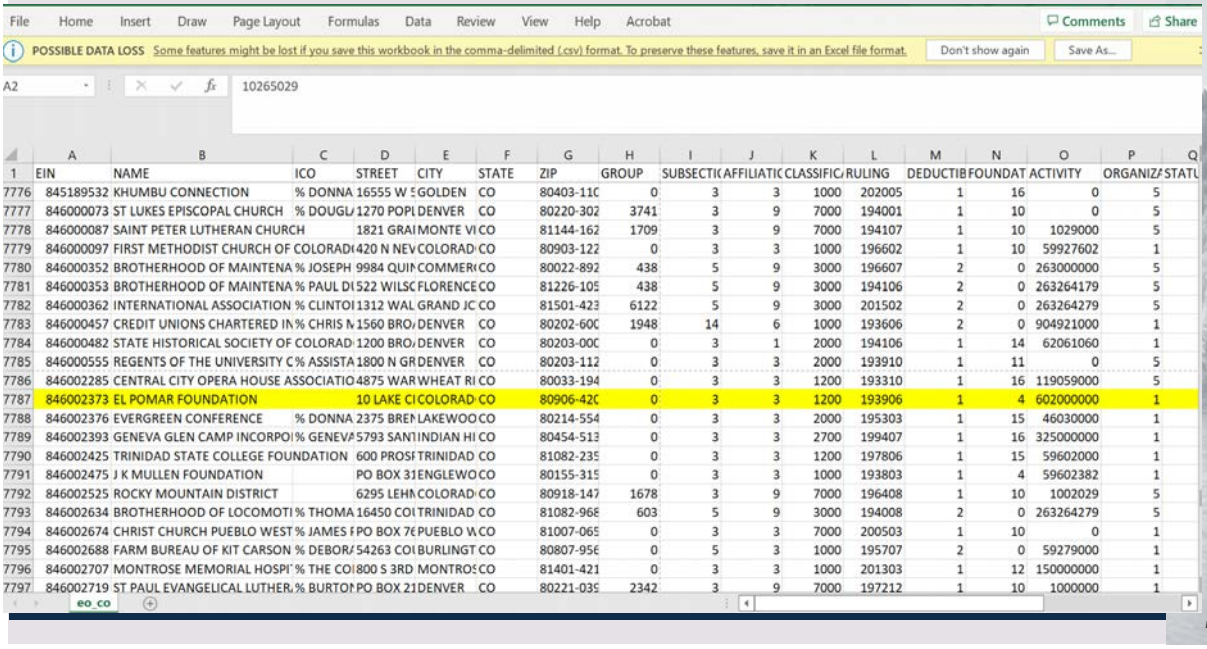


Business Master File



	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q
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7777	846000073	ST LUKES EPISCOPAL CHURCH	% DOUGL/	1270 POPI	DENVER	CO	80220-302	3741	3	9	7000	194001	1	10	0	5	
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7779	846000097	FIRST METHODIST CHURCH OF COLORAD(		420 N NEV	COLORAD(	CO	80903-122	0	3	3	1000	196602	1	10	59927602	1	
7780	846000352	BROTHERHOOD OF MAINTENA	% JOSEPH	9984 QUIN	COMMER(	CO	80022-892	438	5	9	3000	196607	2	0	263000000	5	
7781	846000353	BROTHERHOOD OF MAINTENA	% PAUL DI	522 WILSC	FLORENCE	CO	81226-105	438	5	9	3000	194106	2	0	263264179	5	
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7783	846000457	CREDIT UNIONS CHARTERED IN	% CHRIS N	1560 BRO/	DENVER	CO	80202-600	1948	14	6	1000	193606	2	0	904921000	1	
7784	846000482	STATE HISTORICAL SOCIETY OF COLORAD(		1200 BRO/	DENVER	CO	80203-000	0	3	1	2000	194106	1	14	62061060	1	
7785	846000555	REGENTS OF THE UNIVERSITY C	% ASSISTA	1800 N GR	DENVER	CO	80203-112	0	3	3	2000	193910	1	11	0	5	
7786	846002285	CENTRAL CITY OPERA HOUSE ASSOCIATIO		4875 WAR	WHEAT RI	CO	80033-194	0	3	3	1200	193310	1	16	119059000	5	
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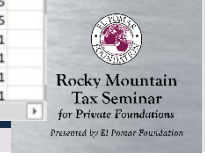
7789	846002393	GENEVA GLEN CAMP INCORPO	% GENEVA	5793 SANT	INDIAN HI	CO	80454-513	0	3	3	2700	199407	1	16	325000000	1	
7790	846002425	TRINIDAD STATE COLLEGE FOUNDATION		600 PROSI	TRINIDAD	CO	81082-235	0	3	3	1200	197806	1	15	59602000	1	
7791	846002475	J K MULLEN FOUNDATION		PO BOX 31	ENGLEWO	CO	80155-315	0	3	3	1000	193803	1	4	59602382	1	
7792	846002525	ROCKY MOUNTAIN DISTRICT		6295 LEHN	COLORAD(	CO	80918-147	1678	3	9	7000	196408	1	10	1002029	5	
7793	846002634	BROTHERHOOD OF LOCOMOTI	% THOMA	16450 COI	TRINIDAD	CO	81082-968	603	5	9	3000	194008	2	0	263264279	5	
7794	846002674	CHRIST CHURCH PUEBLO WEST	% JAMES F	PO BOX 76	PUEBLO W	CO	81007-065	0	3	3	7000	200503	1	10	0	1	
7795	846002688	FARM BUREAU OF KIT CARSON	% DEBORA	54263 COI	BURLINGT	CO	80807-956	0	5	3	1000	195707	2	0	59279000	1	
7796	846002707	MONTROSE MEMORIAL HOSPI	% THE COI	800 S 3RD	MONTROS	CO	81401-421	0	3	3	1000	201303	1	12	150000000	1	
7797	846002719	ST PAUL EVANGELICAL LUTHER/	% BURTOI	PO BOX 21	DENVER	CO	80221-035	2342	3	9	7000	197212	1	10	1000000	1	



Agenda

And if you don't know, now you know.
— Notorious B.I.G. (aka Biggy Smalls), 1972-1997

KPMG

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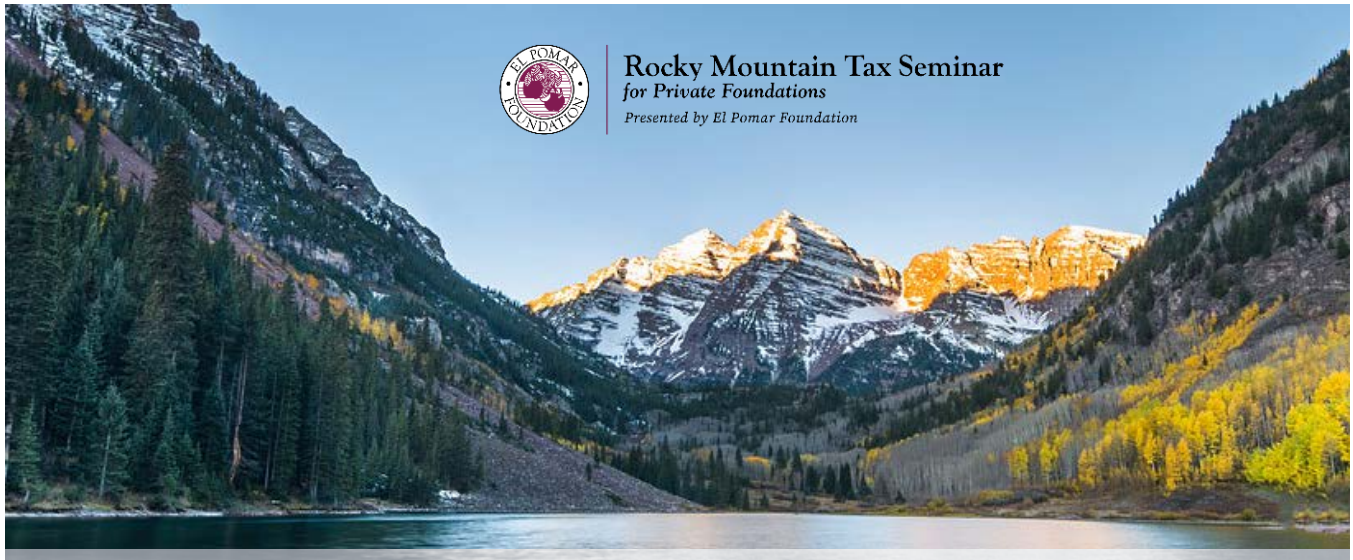
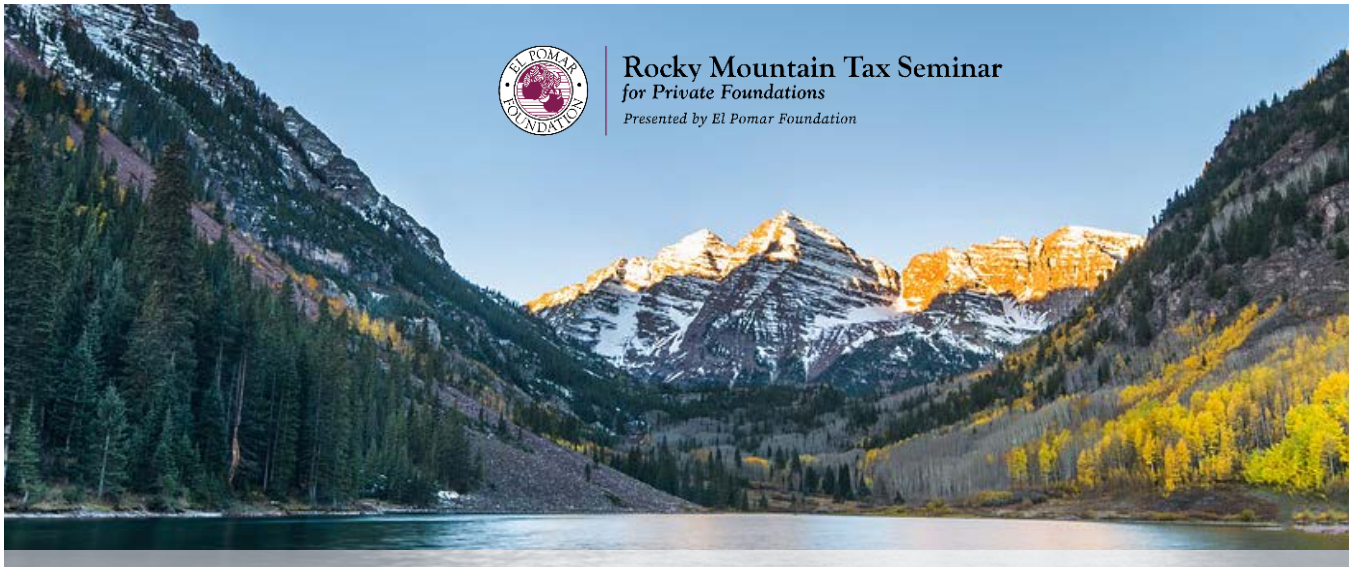


GLAM, TEOS & EO BMF Extract: How Treasury & IRS Communicate about EO Laws & EOs

Ruth Madrigal, KPMG LLP

September 15, 2023



EO Epistemology: What do we know? How do we know it?

Glossary

Bucketing (silo) rule	The federal tax law requires that, when a tax-exempt organization (including a private foundation) has two or more unrelated businesses, unrelated business taxable income must first be computed separately with respect to each business. IRC § 512(a)(6).
Charitable giving rules	The federal tax charitable giving rules pertain to the income, estate, and gift tax deduction rules for charitable contributions (IRC §§ 170, 2055, 2522). They concern matters such as the definition of the terms "contribution" and "charitable." The income tax rules place limitations on how much can be deducted in a tax year, include situations where otherwise deductible amounts must be reduced, and impose restrictions on gifts of certain types of property (such as vehicles and intellectual property) and of partial interests, as well as impose recordkeeping, substantiation, and valuation requirements.
Charitable purpose	Charitable purposes, under the federal tax law, include undertaking such as relief of the poor, relief of the distressed, advancement of education, advancement of religion, advancement of science, lessening the burdens of government, promotion of health, promotion of the arts, and promotion of social welfare. The term is sometimes used in a broader sense, to embrace education, science, and religion, because of the sweep of the charitable contribution deduction.
Correction	This term is used to connote undoing, to the extent possible, a transaction or arrangement that is taxable under the private foundation rules. For example, the term means, with respect to an act of self-dealing, undoing the transaction, to the extent possible, but in any case placing the private foundation in a financial position not worse than that in which it would be if the disqualified person involved was acting under the highest fiduciary standards. (IRC § 4941(e)(3))
Disqualified person	This is a person standing in one or more particular relationships with respect to a private foundation. The types of disqualified persons are (1) substantial contributors; (2) foundation managers; (3) certain 20 percent owners; (4) family members of the foregoing; (5) corporations, partnerships, and trusts in which disqualified persons have more than a 35-percent interest; (6) certain estates; (7) certain other private foundations; and (8) certain government officials. (IRC § 4946)
Donor-advised fund	This is a fund or account that is separately identified by reference to contributions of a donor or donors, is owned and controlled by a sponsoring organization, and with respect to which a donor or representative of a donor has advisory privileges in connection with distribution or investment of amounts held in the fund. (IRC § 4966)
Earmarking	This occurs where money or property is designated for a purpose where there is an agreement, oral or written, by which the transferor may cause the transferee to expend amounts to accomplish a particular purpose; where the transferor has directed the transferee to add the money or property transferred to a fund to accomplish a purpose; or where funds are being directed to a specified individual.

Glossary

Excise tax	Private foundations generally must pay an excise tax of 2 percent on their net investment income, including dividends, interest, and capital gain. This tax can be reduced to 1 percent in a year where qualified distributions exceed the average percentage of value of noncharitable assets over the past 5 years. (IRC § 4940) Also, excise taxes are part of the penalties imposed on private foundations in the case of violation of any of the federal tax private foundation rules.
Excess business holdings	The excess business holdings rules generally limit to 20 percent the permitted ownership of a corporation's voting stock or other interest in a business enterprise that may be held by a private foundation and all disqualified persons combined. If, however, effective control of the business enterprise can be shown to be elsewhere, a 35-percent limit is substituted for the 20 percent limit. (IRC § 4943) These rules do not apply with respect to functionally related businesses or philanthropic businesses.
Exempt operating foundation	This is a private foundation that is exempt from the tax on net investment income imposed on private foundations. This type of entity must have the following characteristics: (1) it qualifies as a private operating foundation, (2) it has been publicly supported for at least ten years, (3) at all times, the governing body of the entity consisted of individuals at least 75 percent of whom are not disqualified individuals and was broadly representative of the public, and (4) at no time did the private foundation have an officer who was a disqualified individual. IRC § 4940(d)(2))
Expenditure responsibility	A private foundation is required to exercise expenditure responsibility over grants to non-public charities, which means exerting all reasonable efforts to see that the grant is spent solely for the charitable purposes for which it was made, obtaining complete reports from the grantee as to how the funds were spent, and making reports with respect to the expenditures to the IRS. (IRC § 4945(h))
Fiscal agent	This is a tax-exempt charitable organization that manages and expends funds or acts in a similar capacity for another exempt charitable organization.
Fiscal sponsor	This is a tax-exempt charitable organization that sponsors a charitable project on behalf of a nonexempt organization, a group of individuals, or an individual. Tax-deductible contributions are received by the sponsor and funds spent in furtherance of a specific project.
Fringe benefit expense rules	Expenses associated with certain fringe benefit plans operated by tax-exempt organizations (including private foundations) must be treated as forms of unrelated business income. IRC § 512(a)(7). These expenses are for a qualified transportation fringe (IRC § 132(f)(1)), a parking facility used in connection with qualified parking (IRC § 132(f)(5)(C)), or an on-premises athletic facility (IRC § 132(j)(4)(B)).

Glossary

Functionally related business	This is a business or activity of a private foundation (1) the conduct of which is substantially related to the foundation's exempt purposes; (2) in which substantially all the work is performed without compensation; (3) carried on primarily for the foundation's employees or visitors; (4) consisting of the sale of merchandise, substantially all of which was received by the foundation as contributions; or (5) carried on within a larger aggregate of similar activities or within a larger complex of other endeavors that is related to the exempt purposes of the foundation. (IRC § 4942(j)(4))
Jeopardizing investment	Foundations are penalized if they invest any amount in a manner that would jeopardize the carrying out of any of its charitable purposes. (IRC § 4944)
Lobbying	Lobbying is a term generally used to describe one or more processes by which a person endeavors to influence the outcome of a legislative process, involving foreign, national, state, or local legislation. These forms of communication are either direct lobbying or grass-roots lobbying. Lobbying, when undertaken by a private foundation, can be a taxable expenditure (IRC § 4945(d)(1))
Mandatory payout	Standard grant making private foundations must distribute, with respect to each year, for charitable purposes an amount equal to 5 percent of the value of the foundation's noncharitable assets. (IRC § 4942)
Mission-related investment	This is an investment made by foundation managers, exercising ordinary business care and prudence that furthers the foundation's charitable purposes, where there is an expected rate of return that may be less than what the foundation might obtain from an investment that is unrelated to its charitable purposes.
Operational test	An operational text, which is the most developed in connection with charitable organizations, is applied to determine whether an organization is being operated primarily for its exempt purposes. There is an additional operational test for private foundations and supporting organizations.
Organizational test	An organizational text, which is the most developed in connection with charitable organizations, is applied to tax-exempt organizations to determine whether the organization is properly organized from the standpoint of the exemption requirements. The emphasis is on a statement of purpose and a dissolution clause. There is an additional organizational test for private foundations and supporting organizations.
Philanthropic business	This is a business wholly owned by a private foundation, where (1) none of the ownership interests were acquired by purchase, (2) all of the business's net operating income is distributed to the foundation, (3) no substantial contributor or family member is a foundation manager or contractor of the foundation, and (4) at least a majority of the members of the foundation's board are not director or officers of the business enterprise. A philanthropic business can be held by a private foundation without violation of the excess business holdings rules. (IRC § 4943(g))

Glossary

Primary purpose rule	A tax-exempt organization must, to remain exempt, engage in activities that are the basis for its exemption as a primary portion of its total activities. This rule is more stringent in the case of private foundations, where expenditures for noncharitable purposes are taxable. Private foundations may, however, derive income from passive unrelated business sources.
Private benefit	Private benefit transactions are much like private inurement transactions, except that insiders are not required; incidental private benefit is permissible.
Private foundation	A private foundation is a type of tax-exempt charitable organization that is not a public charity. A private foundation generally has the following characteristics: (1) it is, as noted, an exempt, charitable entity; (2) it is funded, often in a single transaction, from one source (such as an individual, family, or company); (3) its operating funds are in the form of investment income, rather than an ongoing flow of contributions; and (4) it makes grants for charitable purposes. These standard private foundations are often referred to a private non-operating foundations.
Private foundation rules	The private foundation rules generally consist of (1) an excise tax on net investment income (IRC § 4940), (2) taxation of acts of self-dealing (IRC § 4941), (3) a mandatory payout requirement (IRC § 4942), (4) taxation of excess business holdings (IRC § 4943), (5) taxation of jeopardizing investments (IRC § 4944), and (5) taxation of various expenditures (IRC § 4945).
Private inurement	Forms of private inurement between tax-exempt organizations and their insiders that can lead to loss of exempt status, include unreasonable compensation, and unreasonable rental, borrowing, and sales arrangements.
Private operating foundation	This is a form of private foundation that devotes most of its earnings and much of its assets directly to the conduct of its charitable purposes, as opposed to making grants to other persons. To qualify as a private operating foundation, a private foundation must meet an income test, plus satisfy an assets test, an endowment test, or a support test. (IRC § 4942(j)(3))
Program-related investment	This is an investment the primary purpose of which is to accomplish one or more charitable purposes and no significant purpose of which is the production of income or the appreciation of property. (IRC § 4944(c))
Prohibited expenditure	In the private foundation law context, this is an expenditure that is a taxable expenditure. These expenditures are not literally prohibited but the taxation, correction, and reporting regimes are sufficiently stringent as to effectively amount to a prohibition.
Public charity	A public charity is a tax-exempt charitable entity that is not a private foundation, because it is an institution (e.g., school, hospital, or medical research organization), is publicly supported (as a donative or service provider entity), or is a supporting organization. (IRC § 509(a)(1)-(3))

Glossary

Qualifying distribution	Generally, any amount paid, including reasonable administrative expenses, to accomplish a charitable purpose, other than a distribution to an entity controlled by the private foundation or its disqualified persons, or paid to acquire an asset used for charitable purposes. (IRC § 4942(g))
Sanction	A sanction is a form of punishment for engaging in an act that is a civil or criminal law violation. It can be imposed as imprisonment, an injunction, a penalty, a form of restitution, or a tax. For example, the private foundation rules are underlain with excise taxes and correction requirements that are sanctions.
Self-dealing	Generally, the following transactions between a private foundation and a disqualified person are acts of self-dealing: sale or exchange of property, leasing of property, lending of money or other extensions of credit, furnishing of goods, services, or facilities, payments of compensation, transfers of property for the benefit of a disqualified person, and certain payments to government officials; there are a host of exceptions. (IRC § 4941)
Set-aside	An amount set aside in a year for a specific charitable project may be treated as a qualifying distribution, if payment for the project is to be made over a period not to exceed 60 months. (IRC § 4942(g)(2))
Supporting organization	A supporting organization is an exempt charity that is organized and operated exclusively to carry out the purposes of one or more supported organizations; is operated, supervised, or controlled by one or more supported organizations; and is not controlled by disqualified persons. (IRC § 509(a)(3))
Taxable expenditure	An amount paid or incurred by a private foundation to carry on propaganda or attempt to influence legislation, engage in political campaign activities, make grants to individuals without IRS pre-approval, make grants to noncharities without exercising expenditure responsibility, or make a grant for a noncharitable purpose; there are a host of exceptions. (IRC § 4945)
Tipping	Tipping occurs when a private foundation makes a grant to an exempt charitable organization, thereby, because of the amount transferred, causing the grantee to lose its status as a publicly supported organization.

Glossary

Two percent rule	There are two "two percent rules." One of these rules is used in defining substantial contributors, who are disqualified persons. This type of contributor is a person who contributed or bequeathed an aggregate amount of more than the higher of (1) two percent of the total contributions and bequests received by the private foundation before the close of its tax year in which the contribution or bequest is received by the foundation from that person or (2) $5,000 (IRC § 507(d)(2)). A two percent rule is used in computing public support for the donative publicly supported charitable organization (IRC § 170(b)(1)(A)(vi)). The general rule in this regard is that, in computing the numerator of the support fraction, contributions and grants from individuals, trusts, corporations, and other entities constitute public support to the extent the total amount of support from a donor or grantor during the computation period does not exceed an amount equal to two percent of the organization's total support for the period. Donors and grantors who are related must share a single two percent limitation. This limitation, however, does not generally apply to support received from other publicly supported organizations of the donative type (including from donor-advised funds) or grant support from governmental units.
Unrelated business	This is a business regularly carried on by a tax-exempt organization where the activity is not substantially related to the achievement of the organization's exempt purposes; there are a host of exceptions. (IRC §§ 511-513)
UPMIFA	This is the acronym for the Uniform Prudent Management of Institutional Funds Act, which is a state uniform statute the major goal of which is application of standards of prudence for the investment and management of charitable funds to charitable organizations, including private foundations.

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