Rocky Mountain Tax Seminar
for Private Foundations

Presented by El Pomar Foundation

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DAY 1: WEDNESDAY, SEPTEMBER 11, 2024

8:00 AM-8:45 AM	Shuttle to Penrose House Departs from Broadmoor West
8:15 AM-9:00 AM	Attendee Check-in and Breakfast Penrose House
9:00 AM-9:05 AM	Welcome Kyle H. Hybl, President and CEO, El Pomar Foundation
9:05 AM-9:15 AM	Announcements and Introductions Eleanor Martinez, Jim Hasson and Ruth Madrigal
9:15 AM-10:15 AM	Current Developments Ruth Madrigal and Rosemary Fei
10:15 AM-10:30 AM	Break
10:30 AM-11:00 AM	Key Issues in Grantmaking Ann Batlle
11:00 AM-11:30 AM	Key Issues with Self-Dealing Celia Roady
11:30 AM-12:00 PM	Key Issues with Excess Business Holdings Jim Hasson
12:00 PM-1:00 PM	Lunch Garden Pavilion
1:00 PM-2:00 PM	Practical Issues Confronting Private Foundations Faculty
2:00 PM-2:05 PM	Closing Remarks Maureen Lawrence, Sr. Vice President, General Counsel, and Regional Partnerships Program Officer, El Pomar Foundation

2:05 PM-2:30 PM	Shuttle to Broadmoor West Departs Garden Pavilion - Upper Lot
4:30 PM-5:00 PM	Shuttle to Penrose House Departs from Broadmoor West
4:30 PM-6:30 PM	Welcome Reception, Penrose House – Fountain Courtyard Cocktails and Hors d'oeuvres **Dinner is at your leisure*
6:15 PM-6:45 PM	Shuttle to Broadmoor West Departs from Penrose House

DAY 2: THURSDAY, SEPTEMBER 12, 2024

8:00 AM-8:45 AM	Shuttle to Penrose House Departs from Broadmoor West
8:15 AM-9:00 AM	Breakfast Penrose House
9:00 AM-9:05 AM	Announcements
9:05 AM-9:30 AM	What Private Foundations Need to Know About DAFs Jim Hasson
9:30 AM-10:00 AM	What Private Foundations Need to Know About Fiscally-Sponsored Projects Rosemary Fei
10:00 AM-10:50 AM	PRI and MRI Case Studies Ruth Madrigal and Celia Roady
10:50 AM-11:05 AM	Break
11:05 AM-12:05 PM	General Counsel Roundtable Josh Mintz, Ricardo Castro and Maureen Lawrence
12:05 PM-1:00 PM	Lunch Garden Pavilion
1:00 PM-2:00 PM	Practical Issues Confronting Private Foundations Faculty
2:00 PM-2:30 PM	Shuttle to Broadmoor West Departs from Garden Pavilion - Upper Lot

DAY 3: FRIDAY, SEPTEMBER 13, 2024

8:00 AM-8:45 AM	Shuttle to Penrose House Departs from Broadmoor West
8:15 AM-9:00 AM	Breakfast Penrose House
9:00 AM-9:10 AM	Announcements and Survey Evaluations
9:10 AM-10:25 AM	What Private Foundations Need to Know About Compensation and Employment Taxes Jim Hasson and James Wynn
10:25 AM-10:40 am	Break
10:40 AM-11:30 AM	Key Issues in Charitability Ann Batlle
11:30- 12:30 PM	Practical Issues Confronting Private Foundations Faculty
12:30 PM-1:00 PM	Shuttle to Broadmoor West Departs from Garden Pavilion - Upper Lot

Save the Date: September 10-12, 2025
https://www.elpomar.org/rmts/

2024 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*®.

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).

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.

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*.

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.

Rosemary Fei is a principal at Adler & Colvin in San Francisco, where she has been representing nonprofit and tax-exempt organizations for over three decades. The firm advises the nonprofit sector on the full range of legal issues arising from nonprofit or tax-exempt status; her practice focuses on exempt organizations' public policy, legislative, and election-related work; nonprofit corporate governance and internal disputes; religious orders and organizations; and affiliated nonprofit structures. Ms. Fei is the immediate past Chair of the Exempt Organizations Committee, Tax Law Section, American Bar Association; before that, she served four years as a Vice Chair, after co-chairing its Subcommittee on Political and Lobbying Activities for over a decade. She regularly teaches, provides expert commentary for news media, and has served on numerous nonprofit Boards of Directors. She graduated cum laude from Harvard Law School, and summa cum laude from The Wharton School at the University of Pennsylvania.

James Wynn is a Principal with Quatt Associates who specializes in the assessment and design of compensation and employee benefit plans. He works with a number of advocacy groups, professional societies, educational institutions, foundations, and media organizations in the areas of executive compensation, deferred compensation arrangements, staff compensation systems and structures, and employee benefit plan design.

Prior to joining Quatt Associates, Mr. Wynn was an Associate in the employee benefits and executive compensation practice group of Morgan Lewis. As a lawyer with the firm, he assisted numerous for-profit and not-for-profit clients in finding and implementing creative solutions to their compensation and employee-benefit-related business problems. His experience ranges from qualified retirement plans and deferred compensation arrangements to employment agreements and severance pay agreements.

Mr. Wynn is a graduate of the University of Virginia School of Law and Cornell University's School of Industrial and Labor Relations, where he studied human resource management and organizational behavior. He is a member of both the Virginia State Bar and the District of Columbia Bar.

Joshua Mintz is the Vice President, General Counsel, and Secretary of the John D. and Catherine T. MacArthur Foundation. He is responsible for the overall legal affairs of the Foundation worldwide and is a member of the leadership advisory team on policy matters and strategic direction.

Josh received his J.D. from the University of Miami School of Law, magna cum laude, in 1981. He teaches on Emerging Forms of Philanthropy and the Role of Private Foundations in Effecting Social Change at the Law School.

Josh is the Board Chair of Arc Chicago LLC, the fund established by the MacArthur Foundation to make investments to further the Benefit Chicago initiative. He presently serves on the board of Juvenile Protective Association and Security Council Reports. He has previously served on a variety of not-for-profit Boards and committees, including Collective Shift, the Council on Foundations, Forefront, Francis Parker School, and the Legal Framework Work Group. Josh coordinates the work of MacArthur Advisory Services and has authored or co-authored articles on a range of issues relevant to philanthropy.

Ricardo Castro joined the Robert Wood Johnson Foundation (RWJF) in 2022, bringing over 30 years of legal, nonprofit, and philanthropy experience to his position as vice president, general counsel and secretary. He advises the president, CEO and Board chair, and through them, the Board of Trustees, on legal issues, tax or legislative matters, or regulatory activities.

Previously, Ricardo served as general counsel and secretary of the International Rescue Committee, responsible for the organization’s domestic and international legal affairs.

In his immediately preceding position as general counsel of the Clinton Foundation, he was a member of the senior leadership team.

In prior positions at both Open Society Foundations and the Ford Foundation, in strategic analysis and planning, U.S. and global regulatory compliance, legal and international negotiations, and not-for-profit start-ups and restructuring.

Ricardo received his JD from the New York University School of Law and his BA from the University of Pennsylvania. He resides in Jersey City, N.J., with his husband, Daniel Light.

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.

Current Developments

Rosemary Fei and Ruth Madrigal
September 11, 2024

It's an Election Year

Election Year (and After) Reminders

Under 501(c)(3):

- No "participating or intervening" in any election of a candidate to public office
- Nonpartisan voter education is fine
- (Still) a vague facts-and-circumstances test, including –
  - Explicit references to voting, election, candidates
  - "Coded" references, like issues
  - Continuing activity (long before and after election)
  - Distribution (size, targeting, audience)
  - Lack of other justification (coordination?)
  - Closeness to election (!)

Election Year (and After) Reminders (cont'd)

Additional restrictions for private foundations:

- No lobbying on legislation (which includes ballot measures)
  - Specific project grant ("McIntosh") rule
- No supporting or conducting voter registration drives unless –
  - Conducted by a qualifying c3 organization
  - In at least 5 states, over at least 2 election cycles
  - No earmarking
  - IRS ruling option

Always safe: general support/unrestricted grants

What's Up in Washington?

2025: Tax Changes are Coming…

- **Several of the 2017 Tax Act provisions in the will expire in 2025, including:**
  - Individual rate reductions and modifications of individual AMT
  - Increased standard deduction/elimination of personal exemptions
  - SALT deduction limited to $10k
  - Increased estate tax exemption
  - Increased child tax credit
- **Unfavorable 2017 Tax Act provisions with delays are here, including:**
  - Business interest deduction and NOL limitations
  - Research & experimentation capitalization
- **Non-2017 Tax Act provisions expire in 2025 as well, including:**
  - Employer payment of student loans
  - Employer credit for paid FMLA
- **New tax legislation is being planned**

Recently Proposed Legislation

- **April 15, 2024 - H.R. 6408 passed the House on a bipartisan basis and was sent to the Senate and referred to the Finance Committee**
  - The bill would amend section 501(p) to suspend the tax-exempt status of a "terrorist supporting organization," defined as any organization designated by the Treasury Secretary as having provided (during the three-year period prior to its designation) material support or resources to a "terrorist organization" (OR another "terrorist supporting organization") in excess of a de minimis amount.
  - Would allow suspension of status of every organization "up the chain" of funders
  - Organizations must be given notice of an impending designation and opportunity to cure by showing it did not provide support or by making reasonable efforts to have support returned (but can only rely on returned support option once in 5 years)

H.R. 6408

- **What are the implications of…**
  - A "terrorist supporting organization" (TSO) being treated as a "terrorist organization" (as defined in 501(p)(2))?
  - The 3-year window (prior to designation) for provision of support?
  - The lack of a knowledge requirement for a TSO determination?
  - The fact that the Secretary of the Treasury makes the designation?

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Proposed Legislation (cont.)

- On May 13, 2024, the House Ways & Means Committee voted out of committee four more bills that would impact exempt organizations
  - **H.R. 8290**, the "Foreign Grant Reporting Act" passed by a vote of 38-0
  - H.R. 8291, the "End Zuckerbucks Act" passed by a vote of 23-17
  - H.R. 8293, the "American Donor Privacy and Foreign Funding Transparency Act" passed by a vote of 23-16
  - **H.R. 8314**, the "No Foreign Election Interference Act" passed by a vote of 39-1

Bill text and JCT reports available at: https://kpmg.com/us/en/home/insights/2024/05/tnf-house-ways-and-means-to-mark-up-bills-relating-to-foreign-donations-to-tax-exempt-organizations-jct-descriptions.html

Recent Congressional Action

- On June 3, 2024, six House committees issued letters to 10 universities that detail the committees' intent to investigate the use of federal funds at the universities
- On June 7, 2024, the Education and Workforce Committee Chairwoman Virginia Foxx (R-NC) sent a letter to Northwestern University criticizing its congressional response to date and threatening to issue a subpoena
- On June 12, six Senators wrote to the IRS urging investigation and revocation of the 501(c)(3) status of Palestine Chronicle; Ways & Means Chair Jason Smith wrote a June 10 letter regarding the same
- On June 13, the House Committee on Ways & Means held a hearing entitled, "The Crisis on Campus: Antisemitism, Radical Faculty, and the Failure of University Leadership"

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Proposed Legislation (cont.)

- On July 9, 2024, the House Ways & Means Committee voted out of committee three bills relating to education/educational organizations
  - H.R. 8914, the "University Accountability Act" was passed by a vote of 24-12.
  - H.R. 8913, the "Protecting American Students Act" was passed by a vote of 24-13.
  - H.R. 8915, the "Education and Workforce Freedom Act" was passed by a vote of 23-13.

Bill text and JCT reports available at: https://waysandmeans.house.gov/event/markup-of-h-r-8914-h-r-8913-h-r-8915-and-h-j-res-148/

Charities: "...within the bull's-eye"

- On July 23, 2024, the House Ways & Means Committee held a hearing titled "Fueling Chaos: Tracing the Flow of Tax-Exempt Dollars to Antisemitism."
- In an article about the hearing, Rep. Greg Murphy (R-NC) was quoted as saying: "We're going through tax reform and I'll tell you that [section] 501(c)(3)'s are absolutely within the bull's-eye."*

* *See* Stanton, Cady, "Lawmakers Ponder Options to Address EOs Tied to Antisemitism," TaxNotes, July 24, 2024.

Treasury Guidance

Priority Guidance Plan

1. Guidance revising Rev. Proc. 80-27 regarding group exemption letters. Notice 2020-36 was published on May 18, 2020.
2. Issued 11/20/2023.
3. Regulations under §512 regarding the allocation of expenses in computing unrelated business taxable income and addressing how changes made to §172 net operating losses by section 2303(b) of the CARES Act apply for purposes of §512(a)(6).
4. Guidance addressing the SECURE 2.0 Act changes relating to §529.
5. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

Priority Guidance Plan (cont.)

6. Proposed regulations were published on Nov. 13, 2023.
7. Regulations under §4967 regarding prohibited benefits, including excise taxes on donors, donor advisors, related persons, and fund management
8. Regulations under §4958 regarding donor advised funds and supporting organizations
9. Guidance regarding the public-support computation with respect to distributions from donor advised funds
10. Regulations designating an appropriate high-level Treasury official under §7611. Proposed regulations were published on Aug. 5, 2009.

Final Regulations: Type III Supporting Organizations

- After a more than 7.5 year wait, the IRS finally released final regulations on Type III supporting organizations
  - See T.D 9981 (Oct. 13, 2023).
- The bottom line: few changes to the proposed regulations issued in 2016.
- Generally applicable for taxable years beginning on or after Oct. 16, 2023

Supporting Organization (SO) Requirements - Generally

"**Organized**, and at all times thereafter is **operated**, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations" – which must be public charities described in §509(a)(1) or (2) (and for a Type III, can't be a non-US entity).

Organizational test: SO's governing documents must--

- specify its supported organization (SDOs), generally by name, but Type I and II may designate by "class or purpose"
  - Exception for "historic and continuing relationship" between SO and SDO
- limit purposes to supporting its SDOs and not expressly empower it to engage in other activities/support other organizations

Operational test: SO is operated exclusively to support SDOs "only if it engages solely in activities which support or benefit the specified [SDOs]"

Supporting Organization (SO) Requirements - Generally

- **DP control test:** Cannot be controlled, directly or indirectly, by "disqualified persons" (other than managers or most public charities/their wholly owned organizations)
  - Also: Type I/III SOs cannot receive contributions from a donor that controls a SDO (or certain related persons or entities)

- **Relationship test:** must be controlled by (Type I), controlled in connection with (Type II), or operated in connection with (Type III)
  - Type I – parent/subsidiary relationship between SDO/SO
  - Type II – sibling relationship between SDO/SO
  - Type III (functionally integrated) – SO carries out activities that support SDO
  - Type III (non-functionally integrated) – SO provides annual financial support to SDO

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SO Types: Relationship Test (§ 509(a)(3)(B))

"Operated, supervised, or controlled by" one or more SDOs

Type I

SO is directly controlled by its SDO (parent-subsidiary relationship)

- Established if a majority of the officers, directors, or trustees of SO are appointed or elected by SDO(s) or its members

"Supervised or controlled in connection with" one or more SDOs

Type II

SO and the SDO(s) are under common supervision or control (sibling relationship)

- G.C.M. 39508 suggests Type II requires majority board overlap with every SDO

"Operated in connection with" one or more SDOs

Type III

SO must meet a–

- "notification requirement,"
- "responsiveness test,"
- "integral part test" (FI or NFI)

Final Regs: Notification requirement and responsiveness test

Notification requirement

- Minor difference in the way the timing is described, using the term "Reporting Year"
- Adds that annual notification should include "a brief narrative description of the support provided and sufficient financial detail for the recipient to identify the types and amounts of support being reported"
  - This wasn't in the 2016 proposed regulations

Responsiveness Test

- Type III supporting organizations now must now be responsive to *all* supported organizations.
  - This could be a significant change if there are several supported organizations

Final Regs: Functionally integrated Type III test

Three ways to be functionally integrated

1. Engages in activities substantially all of which directly further the exempt purposes of one or more supported organizations
   - New regulations add nothing on this other than "all pertinent facts and circumstances will be taken into consideration"
2. Is the parent of each of its supported organizations
3. Supports a governmental supported organization

Final Regs: Non-functionally integrated Type III payout

- In calculating required payout – which is generally the greater of 3.5% of assets or 85% of income – the SO can no longer reduce the payout by UBIT paid
- Exclusive list of distributions that count toward the payout:
  - Any amount paid to a supported organization to accomplish the supported organization's exempt purposes
  - Any amount paid by the supporting organization to perform an activity that directly furthers the purposes of one or more supported organizations, but only to the extent such amount exceeds any income derived by the supporting organization from the activity
  - Reasonable and necessary administrative expenses
  - Any amount paid to acquire an exempt-use asset
  - Certain set-asides
  - Certain charitable solicitation expenses

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Proposed Regulations: Donor Advised Funds (DAFs)

- On Nov. 13, 2023, Treasury released the first installment of proposed regulations (REG-142338-07) relating to DAFs
- Comment period was extended to Feb. 15, 2024
- Public hearings to be held on May 6 and 7, 2024
- Proposed to be effective for tax years ending *after* the date final regulations are published in the *Federal Register*
  - *Many comments requested final regulations adopt a prospective effective date*

DAFs - Generally

- **According to §4966, donor advised fund (DAF) is:**
  - a separate fund or account
  - that is owned and controlled by a "sponsoring organization" (which must be a public charity)*, and
  - the donor to the fund (or an appointed advisor) has the privilege of making recommendations regarding distributions from or investments of the fund
- But an account set up to benefit a single public charity is not a DAF

*** Note:** Contributions to a DAF will not be deductible if the sponsoring organization is a Type III non-functionally integrated supporting organization

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DAF Operating Restrictions

- **DAFs are held by public charities but are subject to operational restrictions similar to the way that private foundations (PFs) are restricted, for example:**
  - IRC §4943(e): PF excess business holdings rules are applicable to DAFs
  - IRC §4958(c)(2): automatic excess benefit transaction for certain payments to donors/advisers
  - IRC §4966: excise tax on a sponsoring organization for distributions to individuals or to non-public charities (and certain supporting organizations) without exercising expenditure responsibility or for non-charitable purposes
  - IRC §4967: excise tax on donors/advisors for advising distributions resulting in more than an incidental benefit to the donor

DAF Contribution Substantiation Requirement

In addition to the general substantiation requirements for all charitable contributions, donors to a DAF must obtain a contemporaneous written acknowledgement (similar to the usual requirement for contributions over $250) from the sponsoring organization of the DAF *specifically indicating that the sponsoring organization has exclusive legal control over the contributed assets*.

In *Keefer v. United States*, 130 AFTR 2d 2022-5002 (N.D. Tex. 2022), a $1.26 million deduction for a contribution to a DAF was denied, in part for not meeting this requirement under section 170(f)(18)

DAF Sponsor Owns Contributed Assets – Recent Cases

- ***Fairbairn v. Fidelity Investments Charitable Gift Fund* (N.D. Cal. (Feb. 26, 2021)).**
  - Fidelity prevailed over claims that it violated alleged promises to two donors to DAF
  - Court reasoned that property transferred to DAF is wholly owned and controlled by sponsoring organization, notwithstanding donors' advisory rights

- ***Pinkert v. Schwab Charitable Fund* (N.D. Cal. (June 17, 2021)).**
  - Schwab successfully secured dismissal of case (which included claims about DAF's operations) due to lack of standing since property transferred to a DAF is wholly owned and controlled by the sponsoring organization.

DAF Regulations under Section 4966

Primarily Definitional

- Donor advised fund
- Donor
- Donor advisor
- Advisory privileges
- Taxable distributions

Do not provide guidance on other issues

- Private foundation use of DAFs
- More than incidental benefit (pledges and bifurcated payments)
- Public support
- Payout

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Definition of "separately identified"

- Sponsoring organization maintains formal record of contributions of a donor or donors, or
- Facts and circumstances, including--
  - Account balance reflects contributions, dividends, distributions, expenses, gains and losses
  - Named after a donor or related person
  - Referred to as a DAF or agreement with a donor that it is a DAF
  - At least one donor regularly receives a fund or account statement
  - Sponsoring organization generally solicits advice from the donor/donor advisor before making distributions

Prop. Reg. § 53.4966-3(b)

Definition of "donor"

- Any person that makes a contribution to a fund or account of a sponsoring organization, except it **does not include** a governmental unit or a §501(c)(3) public charity (except disqualified supporting organizations).
- If there is no donor, the fund cannot be a DAF. Any fund that is solely funded by entities that are not donors is not a DAF (and none of the other limitations apply). For example, a §501(c)(3) public charity can set up a scholarship fund at a community foundation and not need to meet the DAF scholarship fund exceptions in the proposed regulations.

Prop. Reg. § 53.4966-1(f)

Definition of "donor advisor"

- Person appointed or designated by the donor to have advisory privileges
- Person who establishes the fund or account and advises as to distributions or investments (memorial fund, wedding fund), regardless of whether the person contributes
- Personal investment advisors – advisors who manage both the assets in a DAF and the personal assets of a donor to that DAF (regardless of whether the donor appointed or designated them)
  - BUT not a donor advisor if providing services to the sponsoring organization as a whole
  - Effect of this definition is that personal investment advisors cannot receive compensation from the DAF (as it would be an excess benefit transaction under section 4958)
- Donor-recommended advisory committee member UNLESS ALL OF THE FOLLOWING:
  - Recommendation is based on objective criteria related to the member's expertise;
  - Committee has 3 or more persons and a majority are not recommended by the donor; and
  - Not a related person (family members and 35%-controlled entities of donor/donor advisor who is an individual)

Prop. Reg. § 53.4966-1(h), (j)

Definition of "advisory privileges"

- Facts and circumstances related to conduct of (or agreement between) donor/donor advisor and sponsoring organization
- Includes privileges from service on an advisory committee
- Applied to the entire fund – if one donor or donor advisor has advisory privileges, then the fund is a DAF
- Advice provided solely in capacity as officer, director, or employee of the sponsoring organization does not itself result in advisory privileges
  - But officer/director/employee has advisory privileges if they're allowed to advise on fund solely because of donations to fund
- A sponsoring organization's appointment of a donor, donor advisor, or related person to an advisory committee relating to a fund will be deemed to result in advisory privileges, unless--
  - Appointment is based on objective criteria relating to expertise of appointee; AND
  - Three or more individuals are on the committee and no more than one-third are related persons with respect to any other members of the committee; AND
  - Appointee is not a significant contributor to the fund or account at the time of appointment.

Prop. Reg. § 53.4966-3(c)

Definition of "distribution"

DISTRIBUTION	TAXABLE DISTRIBUTION	NON-TAXABLE DISTRIBUTIONS	DAISY CHAIN ANTI-ABUSE

• Any grant, payment, disbursement, or transfer from a DAF
• Generally, not investments and reasonable investment or grant-related fees
• Use of DAF assets that results in a more than incidental benefit to a donor
	• To a natural person
	• To any other person if--
	  • It is not for a charitable purpose, or
	  • The sponsoring organization does not exercise expenditure responsibility
		• Distributions to an organization described in §170(b)(1)(A) (but must be for a charitable purpose), including by reason of a equivalency determination
		• The sponsoring organization of the DAF
		• Any other DAF
			• E.g., DAF donates to charity and arranges for charity to distribute to a natural person

Prop. Reg. §§ 53.4966-1(e), 53.4966-5(a)

Exceptions to the definition of a DAF

Funds that are excepted from the definition of DAF

- Single identified organization
- Scholarship funds
- Scholarship funds established by (c)(4)
- Disaster relief funds (broader than employer funds that were previously allowed)

IRC § 4966(d)(2)
Prop. Reg. § 53.4966-4

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Single identified organization

- The term "DAF" does not include any fund established to make distributions only to a "single identified organization" (SIO)
- SIO means a public charity (other than a disqualified supporting organization) or a governmental entity if the distributions to it are exclusively for public purposes.
- To qualify for the exception, the fund can't make distributions to fund grantmaking activities, the administering of a DAF, or distributions to other persons "on behalf of" the SIO
- A fund or account will not be treated as making distributions only to a SIO if either—
  - A donor/donor-advisor/related person may advise on distributions from the SIO to other persons
    - *Example*: If a fund is established to fund only a university, the fund would not meet the "SIO" exception if the donor is on the board of the university because the donor, by virtue of that position, has the ability to advise on distributions from the university.
  - A distribution from the fund provides a more than incidental benefit to a donor/donor-advisor/related person

Prop. Reg. § 53.4966-4(a)

Scholarship funds

The term "DAF" does not include any fund where the donor may advise as to which individuals receive grants for travel, study, or other similar purposes, if—

- The exclusive purpose of the fund or account is to make grants to individuals for travel, study, or other similar purposes;
- The donor/donor-advisor provides advice exclusively in the person's capacity as a member of the selection committee selecting the individuals who receive grants;
- All the members of the selection committee are appointed by the sponsoring organization;
- No combination of donor(s), donor-advisor(s), or related persons controls, directly or indirectly, the selection committee;
- All grants from the fund or account are awarded on an objective and nondiscriminatory basis pursuant to a written procedure approved in advance by the board of directors of the sponsoring organization,
- The fund or account maintains adequate records as described in §53.4945-4(c)(6) that demonstrate the recipients were selected on an objective and nondiscriminatory basis. IRC 4966(d)(2)(B)(ii); Prop. Reg. § 53.4966-4(b)(1)

Final Regulations: Deduction Denial for Easement Contributions

Section 170(h)(7) – added by the SECURE 2.0 Act of 2022 – disallows a qualified conservation contribution deduction made after December 22, 2022, by a partnership or S corporation if the amount of the contribution exceeds 2.5 times the sum of each partner's or shareholder's relevant basis in the partnership/S corporation. Statutory exceptions for:

1. Contributions by a "family partnership" (one where substantially all of the partnership interests are held by an individual and their family members);
2. Contributions made after a 3 year holding period;
3. Contributions made for the purpose of preserving a certified historic structure

Proposed regulations were issued Nov. 17, 2023, providing definitions, explanations, computational guidance, and examples relating to section 170(h)(7).
Final regulations were issued June 18, 2024.

IRS Examination Priorities

FY23 TE/GE Accomplishments Letter Pub. 5329 (Rev 12-2023)

A message from the **TE/GE Commissioners**

IRS **Edward T. Killen** Commissioner, TE/GE & **Robert S. Choi** Deputy Commissioner, TE/GE

Hello,

Thank you for helping us accomplish our strategic goals and mission while promoting voluntary compliance to the tax-exempt sector. Our fiscal year 2023 Accomplishments Letter provides a detailed overview of our successes.

The IRS after years of underfunding, is now able to make significant modernization and transformation improvements and enhance operations thanks to **Inflation Reduction Act (IRA)** funding, which amounts to roughly $60 billion over the next decade. With this increased funding and a dedicated workforce, Tax Exempt and Government Entities (TE/GE) made significant operational enhancements in fiscal year 2023.

Below is a snapshot of our achievements:

- Working in collaboration with Information Technology, we started using the Document Upload Tool for Taxpayer Facing Employees (DUT – TPFE) with most of the Determinations community and we plan to offer this digital tool to additional taxpayers in fiscal year 2024. DUT – TPFE allows taxpayers to electronically upload responses to requests for information to a portal on IRS.gov; thus, reducing case processing time and the need to send paper documents through the mail.
- In partnership with Research, Applied Analytics, and Statistics (RAAS), we created the Exempt Organizations Graph Exploration Tool (EOGET), an interactive graph tool designed to help EO examiners and classifiers conduct risk analysis and identify potential insider abuse among tax exempt organizations – a process that was extremely laborious in the past.
- The examination Lean Six Sigma team continued moving forward with its recommendations to improve exam-related processes and in early 2024, we will publish the new TE/GE Consolidated Examination Internal Revenue Manual (IRM) which will replace the existing functional IRMs.

Edward T. Killen
Commissioner, TE/GE

FY23 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 compliance strategy examinations relate to filing requirements, for-profit conversions, and **self-dealing**."

Collaborative Partnerships included:

- "In fiscal year 2023, 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 2024."

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

Raced-Conscious Grantmaking

June 2023: SCOTUS decides *Students for Fair Admissions* cases (*SFFA*)

- Harvard (private, but federal funding through student loans)
- University of North Carolina (public)

Decision –

- Unconstitutional to use applicant's race in college admissions decisions, where federal funding or a state agency is involved
- May pursue a racially diverse student body through race neutral means
- May consider student essays addressing race or related experiences

Responses by plaintiffs (with mixed results) –

- Application beyond college admissions (scholarships, programs)
- Application beyond educational context (law firms, businesses, government)

Race-Conscious Grantmaking

Legal Framework –

- Equal Protection Clause of the 14th Amendment
  - "No **State** shall … deny to any person … the equal protection of the laws"
- Civil Rights Act of 1964
  - Title VI: Prohibits discrimination on the basis of **race, color, or national origin** in programs/organizations that receive **federal funds**, whether private or public
  - Title VII: Prohibits **employers** from discriminating on the basis of **race, color, religion, sex, or national origin**
- Section 1981 of the Civil Rights Act of 1866
  - Guarantees all U.S. citizens the same rights "as is enjoyed by white citizens" to make/enforce **contracts**
  - Requires intent: that **race** was the "but for" cause for no contract

Raced-Conscious Grantmaking

The *Fearless Fund* case –

- Brought in August 2023 by American Alliance for Equal Rights (AAER)
- Challenges Strivers Contest for grants to businesses owned by Black women
  - Black women entrepreneurs have historically experienced extreme difficulty raising early capital
- Presents the race question outside of State action, federal funding or employment contexts

Issues presented –

- Are grants "contracts" subject to Section 1981?
  - Website called contest rules a contract
  - Applicants must agree to contest rules, grant Fund some publicity rights
- Does the First Amendment create an exception to Section 1981?

Race-Conscious Grantmaking

Procedural status –

- September 26, 2023: District court judge denied injunction
- 4 days later: 11th Circuit panel reversed; enjoining Strivers contest until decision on the merits
  - Split decision, 2-1
  - Two Circuit judges found it "likely that AAER would prevail on the merits"
- Injunction applies only to the parties
- This is not a final decision in the case

What's next?

- Decision on the merits at the District Court level – timing uncertain
- Appeals process, through 11th Circuit to SCOTUS, potentially

Raced-Conscious Grantmaking

Potential remedies if Fearless Fund loses –

- Temporary injunction becomes permanent
- Unclear any other remedies are available to these plaintiffs
- Plaintiffs can't prove they would have been selected if Black women

Jurisdictional issues –

- District Court decision will apply in that District
- 11th Circuit decision, if any, will apply in Alabama, Georgia, and Florida
- SCOTUS decision, if any, will apply nationwide

Stay tuned. And if you make grants in the 11th Circuit, be ready.

Race-Conscious Grantmaking

Reactions to lawsuits and uncertainty–

- Grantmakers pulling back from race-conscious grantmaking
- Grantmakers eliminating grantee obligations and grant agreements
- Businesses cutting DEI programs and staff
- Government programs modified to eliminate race-consciousness

And also –

- Systematic tracking of litigation and sharing information
- Educational support for grantees and funders
- Risk analysis – understanding real risks and perception of risk
- Modifying programs to manage risk
- Legal defense funds and access to legal advice
- Renewed commitment to seek racial justice/equity despite the risk

Decisions for Race-Conscious Grantmakers

Options if you make race-conscious grants now –

- **Eliminate** all race consciousness in grantmaking
  - No exposure to lawsuit
  - Impact on mission
  - Can that be mitigated? Alternatives to race (education, wealth, zipcode, etc.)
- Continue race consciousness but **reduce risks**. Examples:
  - Eliminate grant agreements/grantee obligations
  - Change role of race in selection process (recruiting vs selecting)
  - Focus on individual harms experienced instead of assuming harm from
  - Keep a low profile – don't be the low-hanging fruit
- **Continue** without changes
  - Exemplify leadership (with high risk tolerance)
  - Maximize mission impact
  - Nothing to do now

Decisions for Race-Conscious Grantmakers

Options if you get sued –

- Settle quickly
  - Minimizes expense and distraction
  - Eliminates risk of creating bad precedent
- Litigate
  - Expense and distraction
  - Risk of losing
  - Risk of creating bad decision that applies more broadly (even if you win initially)

Don't stop what you're doing while it's legal;
Try not to be the one sued; and
If it becomes illegal, stop doing it.

Risks to 501(c)(3) Exemption

What's the rule?

- Illegal activities/activities that violate a fundamental public policy are not charitable
  - Whose law/policy? Federal vs. status, U.S. versus foreign
  - How much illegal/non-charitable activity permitted?
  - Qualitative and quantitative considerations

The Bob Jones University case

- Poster child for loss of exemption – policy against interracial dating

Could that apply here?

- What's out of bounds is currently unclear, and clarity may be slow to come
- Bob Jones had many opportunities over many years to change its policy rather than lose exemption
- But that assumes no change in current law or IRS procedures …

No need for current concern (but that could change)

IRA Clean Energy Credits

IRA Energy Tax Credits

- The Inflation Reduction Act made changes longstanding energy tax credits
  - Significant enhancements/modifications made to existing energy tax credits
  - New credits added for additional technologies and activities
  - For many credits, if new prevailing wage and apprenticeship requirements are met, the **base credit starts at 30%** (vs. 6% if not met)
  - Additional "bonus" credit rates possible - depending on the type of property, where the property is placed in service, and whether domestic content thresholds are met – for potential credit rates of **up to 70%** of the eligible cost basis of the energy property
  - **New "direct pay" election allows tax-exempt and government entities to access credits by making them "refundable" and "turning off" provisions of prior law prohibiting government and exempt organizations from taking credits.**

Elective payment (aka "direct pay") for clean energy credits

- Tax-exempt and government entities can make a "direct pay" election and receive a cash refund for the amount of several specified credits (to the extent it exceeds their UBIT 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 <u>tax years</u> beginning after December 31, 2022.**
  - For property placed in service in 2023, only property placed in service *after the start of the organization's tax year beginning in 2023* will qualify for direct pay

Four popular credits for exempt organizations (direct pay eligible)

- Sec. 30C – Alternative fuel vehicle refueling property credit
- Sec. 45W – Credit for qualified commercial clean vehicles
- Sec. 48 – Energy credit (Investment Tax Credit) * +
  - Covers approximately 16 types of property, including:
    - Solar panels
    - Combined heat and power systems (cogeneration)
    - Geothermal heat pumps
    - Energy storage technology
- Sec. 48E – Clean electricity investment credit * #
  - Technology neutral, zero emissions

* Special phaseout rule for direct pay if domestic content requirements aren't satisfied.
\+ Beginning of construction *before 2025* (except geothermal heat pumps - before 2035)
\# Placed in service *after 2024*

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§ 48/48E Investment tax credit (ITC)

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

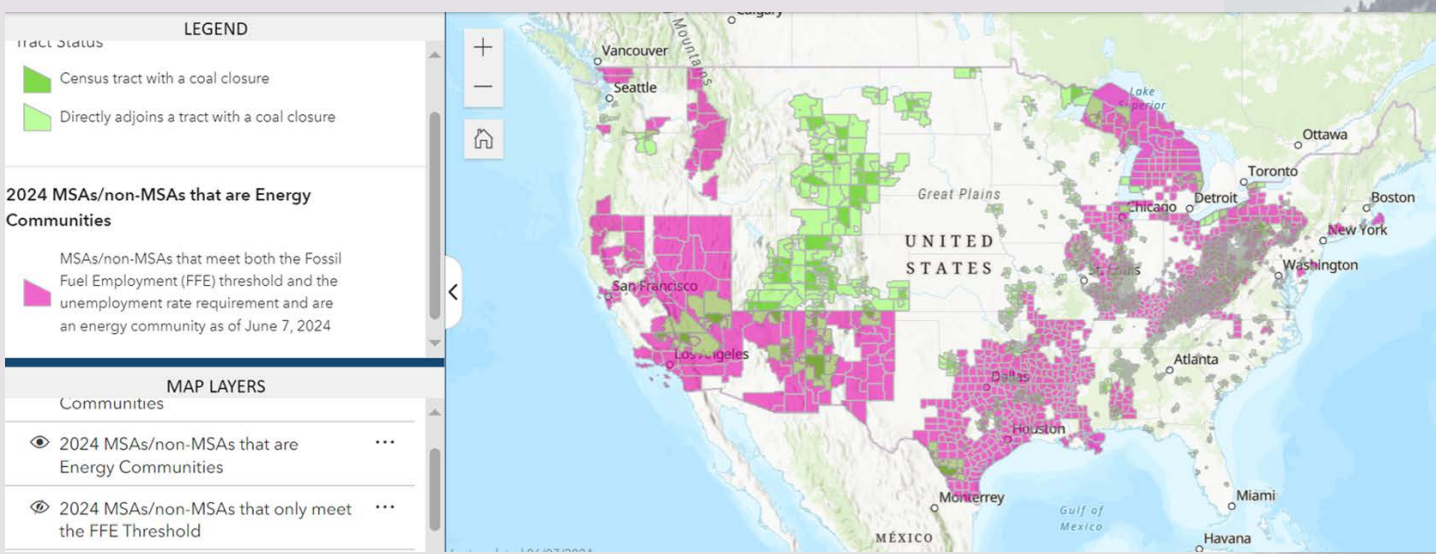
Eligible Basis

- 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 without prevailing wage & apprenticeship (e.g., 6%)
- Prevailing wage & apprenticeship multiplier (x5 = e.g. 30% base rate)
- Domestic content bonus (add up to 10%, potential reduction if not met)
- Energy community bonus (add 10%)
- Low-income communities bonus (add 10/20% - by application only)

DoE Energy Community Mapping Tool



Bonus Rates Add Up: Example

Example: Exempt organization plans to install solar panels (under 1 Mw capacity) to provide power for a building on land that is in a low-income census tract and in an energy community. They received an allocation of the low-income community bonus credit. Cost is $300,000 (assume all eligible costs). Total tax credit is $150,000 (300,000 x 50%).

Investment tax credit	Rate	
Base rate (PWA)	30%	PWA base (no PWA requirement bc <1Mw)
Energy community	10%	Formerly reliant on fossil fuels/coal mine closure
Domestic Content	--	No bonus; but no reduction (1 Mw exception)
Low income community	10%	Allocated bonus – must apply with DOE
Total credit rate	50%	

Clean energy can pay for itself

Example: Annual energy bill is $30,000 currently; with the solar project, the annual electricity bill will be $5,000, freeing up $25,000 per year in operating costs for the life of the project. Assume grant of $50,000; credit bridge loan of $150,000, and project debt of $100,000.

	0	1	2	3	4	5
Project Costs	300,000					
Grant	50,000					
Debt	250,000	250,000	225,000	50,000	25,000	0
Savings - pay project debt		25,000	25,000	25,000	25,000	
Tax Credit - pay bridge loan			150,000			
Savings for charitable uses	0	0	0	0	0	25,000

Credit Amount Adjustments

- Underlying credit provisions (e.g., § 48) may provide that the 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 provide a reduction of 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" and the grant plus potential credit amount exceed cost basis in the energy property.
  - Credits impacted: Sections 30C, 45W, 48, 48C, 48E

Direct Pay Election - Purpose

"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

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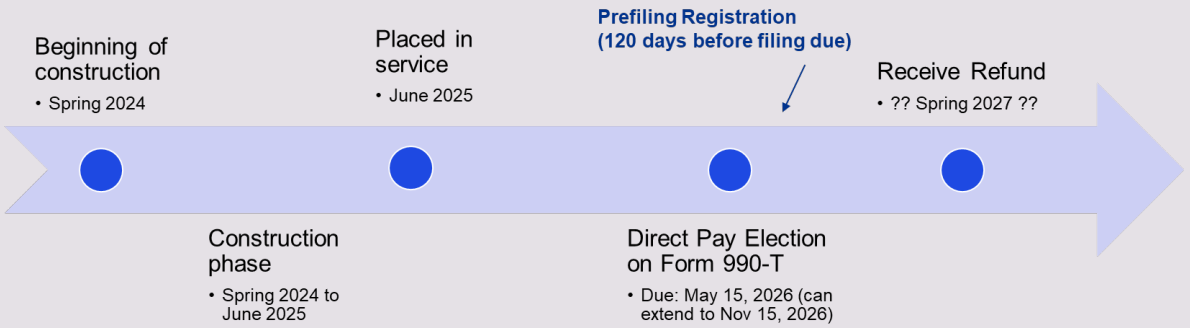
Inflation Reduction Act – Selected Guidance

- Treasury issued final regulations on Mar. 5, 2024, addressing the Inflation Reduction Act provisions for elective pay ("direct pay") under Section 6417
  - Tax-exempt and government entities can receive direct payments for the value of qualifying clean energy projects or qualifying investments (available for 12 of the Inflation Reduction Act's clean energy tax credits).
- Pre-filing registration portal for elective pay has been open since the end of 2023. IRS Publication 5884 provides a user guide and instructions.
- Notice 2024-9 (issued Dec. 28, 2023) provides transitional procedures for claiming statutory exceptions to the application of phaseouts for certain elective pay projects that fail to satisfy "domestic content" requirement and requests comments to inform future guidance.
- Notice 2024-41 (issued May 16, 2024) modifies the existing domestic content safe harbor in Notice 2023-38 and provides a new elective safe harbor for meeting the domestic content bonus credit thresholds under sections 45, 45Y, 48, and 48E.

Tip 1: File Form 990-T on Time

- Direct pay election for EOs must be made on a TIMELY FILED Form 990-T (including extensions)
  - Cannot make election for the first time on an amended return
  - But CAN file an amended return to revise the amount of the credit
  - Must allow enough time for the pre-filing registration process
    - IRS initially said to allow 120 days to get registration numbers back
    - On August 14, the IRS issued a news release (IR-2024-210) strongly urging organizations to complete the prefiling process for projects placed in service in 2023 if they plan to claim direct pay (also known as elective pay).
  - Non-filers did not have to request extension for 2023

Direct Pay Election Timeline – Example*



*Assume calendar year organization

Tip 2: Domestic content is NOT OPTIONAL for EOs

- Organizations that want to use direct pay MUST meet domestic content requirements after 2023 (if they don't qualify for an exception)
  - Phase out has started – credit for projects beginning construction in 2024 is reduced by 10% (15% if begins in 2025)
  - Credit eliminated for projects beginning construction after 2025
  - Exceptions:
    - Project is under 1 MW
    - Insufficient domestic supply
    - Domestic cost is more than 25% more expensive
  - Must consider this when contracting

Domestic Content Reduction (for Direct Pay Only)

- For direct pay, main investment and production tax credits for projects of 1 megawatt or more **phase down beginning in 2024** if domestic content requirements are *not* met:

Begin Construction	% of Credit Available for Direct Pay
Before 2024	100%
In 2024	90%
In 2025	85%
After 2025	0%

- Statute provides Treasury shall provide exceptions (a) if there is insufficient US supply or (b) if use of US content would increase costs by more than 25%
- Notice 2024-9 provides guidance on how to claim statutory exceptions for property beginning construction before 1/1/25; requests comments to inform forthcoming proposed regulations

Tip 3: Tax changes are coming – direct pay could be ended

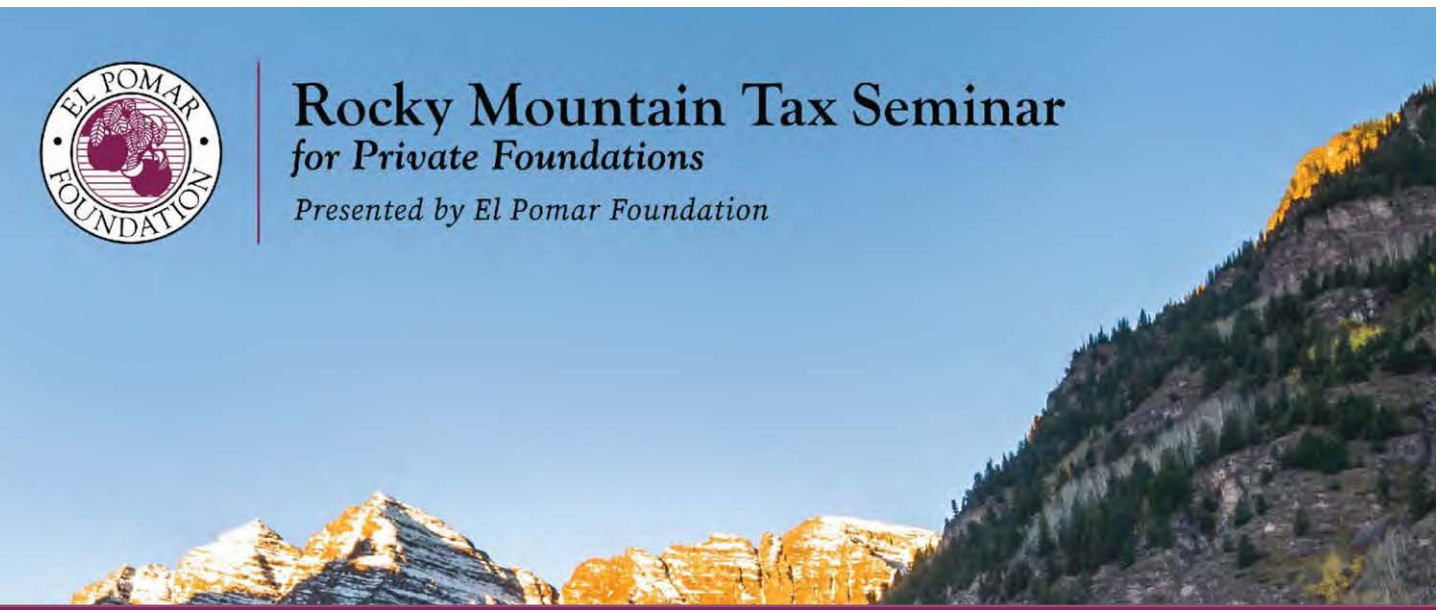
- Tax-exempt organizations are being attacked as unworthy of tax-exempt status
- IRA credits are being attacked as a “Green New Scam”
- IRS and Congress are wary of abuse of credits
- Repeal would raise significant revenue

Exempt Organizations should think about clean energy NOW

- Clean energy often less expensive, more consistent with other values
- Owned energy assets provide control over operating expenses

AND

- Federal tax credits of 30-50% or more of eligible costs are available for the first time for tax-exempt, tribal and governmental entities
- Federal funding (grants and/or loans) in Bipartisan Infrastructure Act and Inflation Reduction Act may be available
  - Greenhouse Gas Reduction Fund - $27 billion to fund clean energy and climate projects and reduce greenhouse gas emissions, with focus on low-income/disadvantaged, rural, and tribal communities
- May be state funding or other private funding available (grants/loans)



Current Developments

Rosemary Fei and Ruth Madrigal
September 11, 2024

Key Issues in Grantmaking

Ann K. Batlle, Morgan Lewis
ann.batlle@morganlewis.com
September 11, 2024

Overview

- Grants subject to Section 4945 Taxable Expenditure Rules
- Lobbying and Political Activity Considerations
- Individual Grant Rules & Procedures
- Grants to Organizations & Expenditure Responsibility

Section 4945(d): Taxable Expenditures

- Carrying on propaganda or influence legislation (§4945(d)(1))
- Influencing an election; carrying out voter registration drives (with exceptions!) (§4945(d)(2); 4945(f))
- Grants to individuals for travel, study, or other similar purposes (unless . . .) (§4945(d)(3); 4945(g))
- Grants to organizations other than a public charity or exempt operating foundation ***unless*** exercising expenditure responsibility (§4945(d)(4); 4945(h))
- Carrying out a non-charitable purpose (§4945(d)(5))

Section 4945: Exceptions

Certain expenditures **not** treated as taxable expenditures:

- ✓ Qualifying distributions
- ✓ Investment-related expenses, including those related to evaluating and making program-related investments
- ✓ Payment of taxes
- ✓ Administrative expenses (wages, consultant fees) that are reasonable and made with ordinary business care and prudence

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Lobbying Issues

- General rule: No expenditures for direct or grassroots lobbying
- "Lobbying" defined in Treas. Reg. § 56.4911-2

Treas. Reg. § 56.4945-2(a), -2(d)

- General support grants to public charities that engage in advocacy are permissible if **not earmarked** for lobbying

Treas. Reg. § 56.4911-2(a)(6)(i)

Lobbying Issues: Project Grants

Grants to charities that lobby*
Treas. Reg. § 53.4945-2(a)(6)(ii)

Do not earmark for lobbying activities	Grant amount does not exceed budget for nonlobbying activities	Can rely on grant budget or other sufficient evidence from grantee

* See December 9, 2004 IRS information letter to Charity Lobbying in the Public Interest, available at: https://cof.org/sites/default/files/documents/files/IRS_Letter_on_Funding_Nonprofits_That_Lobby.pdf

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Campaign Intervention

Prohibits expenditures to support/oppose a candidate for election to public office, including:

- Publishing/distributing written statements or making oral statements on behalf of, or in opposition to, a candidate,
- Paying salaries or expenses of campaign workers, or
- Conducting or paying the expenses of a voter registration drive limited to the geographic area covered by the campaign.

Voter Registration

Section 4945(f) permits funding for certain voter registration activities carried out by a 501(c)(3) grantee, provided that:

- The grantee expends ≥ 85% of its income for its own <u>direct conduct</u> of exempt function activities;
- The grantee receives substantially all its support from exempt organizations, the government, and general public, with ≤ 25% from one entity and ≤ 50% from investment income;

(continued . . .)

Voter Registration

(…continued)

- Grantee's activities are nonpartisan, carried on in five or more states, and not confined to one election period; and
- Contributions made to support voter registration work cannot be subject to conditions that they only be used in specified states or election periods

These limitations apply only to voter registration drives and not get-out-the-vote efforts and similar activities.

Individual Grants

INCLUDES

- Grants to individuals for travel, study, or similar purposes
- Could be in the form of scholarships, fellowships, internships, prizes, awards, loans

EXCLUDES

- ✓Compensation for services
- ✓Grants for other purposes:
  - ✓Grant to indigent individual for basic needs
  - ✓Awards for past achievements

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Individual Grants: Earmarking

Grants to an intermediary organization that makes individual grants are not attributed to the private foundation grantor, if:

- The grant is not earmarked for a named individual, and
- There is no oral or written arrangement to designate specific individual recipients.

Intermediary organizations should control the grantee selection process and make decisions independently of the foundation.

Individual Grants Procedures

Travel, study and similar grants to individuals are permissible, if:

- Awarded on an objective and nondiscriminatory basis;
- Pursuant to procedures **approved in advance** by the IRS;*

Treas. Reg. § 53.4945-4

AND

- Can be requested as part of a Form 1023 Application for Exemption for new foundations, or on Form 8940 (Miscellaneous Determinations) for existing foundations

Individual Grants Procedures

Demonstrated to the IRS's satisfaction to be:

- A scholarship/fellowship for study at a 170(b)(1)(A)(ii) educational institution,
- A prize/award to recipient selected from the general public, or
- A grant for the purpose of achieving a specific objective, produce a report, or enhance grantee's literary, artistic, musical, scientific, teaching or other capacity/skill/talent

Individual Grants: LLC Considerations

- LLC with individual sole member + disregarded for tax purposes ➡ May be a grant to an individual
- Assess purpose of the loan (Travel/study? Other purpose?)
- Identify potential subgrantees/secondary recipients that implicate the individual grant rules
- Consider treatment as a grant to an organization and exercise responsibility

Grants to Organizations: Charities

Grants to the following recipients are not taxable expenditures:

- publicly supported charities, including donor-advised funds
- supporting organizations (other than non-functionally integrated Type IIIs)
- exempt operating foundations described in § 4940(d)(2)

Grants to fiscal sponsors are permissible provided they exercise financial and programmatic responsibility for the supported project.

Grants to Organizations: Expenditure Responsibility

Grants to any organizations other than those on prior slide, require the exercise of expenditure responsibility; four key elements:

Pregrant Inquiry

- Sufficient to provide reasonable assurance that grantee will use funds for proper purposes
- Maintain documentation of process

Written Grant Agreement

Specify purpose of grant; Require grantee to agree to:

- Use funds only for the purpose and repay funds not so used
- Submit full and complete annual reports on use of funds
- Maintain books and records of receipts and expenditures and make available to grantor
- Not use any funds for any taxable expenditure (see Slide 2)

(§ 4945(h); Treas. Reg. § 53.4945-5(a))

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Grants to Organizations: Expenditure Responsibility

Grantee Reports	• Annual reporting from grantee (usually with a final report) • Reporting on use of funds; compliance with grant terms; progress made towards achieving grant purposes
IRS Reporting – Form 990PF	• Name and address of grantee; date, amount and purpose of grant • Amount expended by grantee based on most recent grantee report • Whether any grant funds have been diverted • Dates of grantee reports, and dates + results of any verification of such reports

Grants to Organizations: Foundations

Grants to private non-operating foundations require:

- Expenditure responsibility, AND
- Compliance with out of corpus rules (Treas. Reg. 53.4942(a)-3(c)(1))
  - Grantee must make qualifying distributions out of corpus (i.e., in addition to existing distribution requirements) in the amount of the grant by the end of the fiscal year following the year the grant is made.
  - Grantor must obtain records regarding the distribution, the recipients, and the distribution's out of corpus treatment.

Grants to Organizations: Foreign Equivalents

"Foreign equivalents" of US public charities can be treated as such under Section 4945 (Treas. Reg. § 53.4945-5(a)(5))

Requires a good faith determination based on "current" written advice from a "qualified tax practitioner" (*See* Rev. Proc. 2017-53)

NGOSource: established in 2013 to streamline equivalency determinations and reduce costs – their approach permitted under regulation changes finalized by the IRS & Treasury in 2015

Thank You

Key Issues in Grantmaking

Ann K. Batlle, Morgan Lewis
ann.batlle@morganlewis.com
September 11, 2024

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: DEC 0 9 2004

Contact Person:
Ward L. Thomas
Identification Number:
50-09822
Contact Number:
(202) 283-8913

Charity Lobbying in the Public Interest
2040 S Street NW
Washington, DC 20009

Dear Sirs:

We have considered your request dated February 10, 2003 on behalf of a public charity involved in educating other charities about the role of lobbying as a means of achieving their philanthropic missions. You request information on lobbying and influencing public policy by private foundations. The public charity has compiled a list of recurring questions that, if answered by the IRS, would assist in correcting misconceptions in this area. The questions are addressed below.

1. May private foundations make general support grants, other than program-related investments, to "public charities" that lobby?

Yes, private foundations may make grants, other than program-related investments, to public charities (i.e., organizations described in sections 509(a)(1), (2), or (3) of the Internal Revenue Code) that lobby, with certain restrictions. The tax rules include explicit safe harbors for general support grants that meet the requirements of section 53.4945-2(a)(6)(i) of the Treasury Regulations. Provided that such grants are not earmarked in whole or part for lobbying, they will not be taxable expenditures.

2. Does the same answer apply whether or not the public charity has made the election under section 501(h) of the Code governing its own lobbying expenditures?

Yes.

3. What constitutes "earmarking" of a grant for lobbying?

"Earmarking" a grant for lobbying is making a grant with an oral or written agreement that the grant will be used for lobbying.

4. Absent any specific agreement to the contrary, will the recitation in a grant agreement that "there is no agreement, oral or written, that directs that the grant funds be used for lobbying activities" be sufficient to establish to the satisfaction of the IRS that there has been no earmarking for lobbying?

Yes, absent evidence of an agreement to the contrary.

5. Is a foundation required to include a specific provision in its grant agreements that no part of the grant funds may be used for lobbying?

A specific provision is required only if the grantee organization is not a public charity, or if the private foundation earmarks the grant for use by an organization that is not a public charity.

6. Under what circumstances can a foundation make a grant to a public charity for a specific project that includes lobbying?

A private foundation can make a grant to a public charity for a specific project that includes lobbying pursuant to sections 53.4945-2(a)(6)(ii) and (iii) of the regulations if (1) no part of the grant is earmarked for lobbying, (2) the private foundation obtains a proposed budget signed by an officer of the public charity showing that the amount of the grant, together with other grants by the same private foundation for the same project and year, does not exceed the amount budgeted, for the year of the grant, by the public charity for activities of the project that are not lobbying, and (3) the private foundation has no reason to doubt the accuracy of the budget.

7. In the response to the preceding question, does it matter that the public charity's proposal indicates that it will be seeking funds for the specific project from other private foundations without referring to other, additional sources of funds?

No, the specific project grant rules in section 53.4945-2(a)(6)(ii) of the regulations do not require the private foundation to concern itself about the other sources of funding for the project in such situations.

8. What if, in the conduct of the project, the public charity actually makes lobbying expenditures in excess of its estimate in the grant proposal?

If the requirements of section 53.4945-2(a)(6)(ii) and (iii) of the regulations are met (no earmarking, budget shows non-lobbying equal to or greater than grant, and no reason to doubt accuracy of budget), then the private foundation will not have made a taxable expenditure under section 4945(d)(1) of the Code for that year, even if the public charity makes lobbying expenditures in excess of the budgeted amount. However, knowledge of the excess may provide a reason to doubt the accuracy of subsequent budgets submitted by the public charity.

Section 53.4945-2(a)(7)(ii) of the regulations, Example (13), illustrates the situation where a private foundation makes a second-year grant payment after the public charity exceeded its lobbying budgeted amount in the first year of the grant. In that case, although the private foundation did not have a taxable expenditure in the first year, it did have a taxable expenditure in the second year when the public charity again exceeded its lobbying budgeted amount. Similarly, if the public charity's exemption is revoked for excess lobbying after receiving the grant, there is no adverse consequence to the private foundation unless it directly or indirectly controls the public charity or has knowledge of the change in status before making the grant.

9. In determining whether a foundation grant has been earmarked for lobbying, do the definitions of lobbying in sections 56.4911-2 and 3 of the regulations govern?

Section 53.4945-2(a)(1) of the regulations provides that the definitions of section 56.4911-2 and section 56.4911-3 apply without regard to the exceptions contained in section 56.4911-2(b)(3) and section 56.4911-2(c). Instead, similar exceptions are provided in section 53.4945-2(d). Note that the special rules for membership communications under section 56.4911-5 do not apply to private foundations.

10. Private foundations are required to make "all reasonable efforts" under section 4945(h) of the Code to ensure that grant funds subject to expenditure responsibility (for example, a grant to a section 501(c)(4) organization) are not used for lobbying. Assuming grant records reflect that a grantee has been made aware of the applicable lobbying definitions and the grantee's report on the use of grant funds reflects activities that are legislation-related but, as reported, lack one or more of the elements of lobbying under sections 53.4911-2 and 3 of the regulations, is the foundation required to investigate further to discharge its responsibilities?

Section 53.4945-5(c)(1) of the regulations provides that a grantor private foundation is not required to conduct any independent verification of reports from grantees unless it has reason to doubt their accuracy or reliability.

11. May private foundations directly engage in any policy-related activities without incurring liability for private foundation excise taxes?

Yes. Private foundations may engage directly in a wide range of educational activities that influence the formation of public policy but are not lobbying so long as the foundation does not (1) reflect a view on specific legislation in communications with legislators, legislative staff, or executive branch personnel participating in the formulation of legislation, or (2) reflect a view on specific legislation and make a call to action in communications with the general public (and the rule for certain "mass media" communications does not apply). Some communications that may otherwise qualify as lobbying are excepted as nonpartisan analysis, technical advice to a legislative body, or self-defense.

12. What other policy-related activities may foundations fund?

Private foundations may fund discussions of broad social problems, as well as certain public charity membership communications that are not treated as lobbying communications. Further, the special restrictions on lobbying have no effect on contact with executive branch officials in order to influence the development of regulations (and other non-legislative policy positions). "Lobbying" is limited to attempting to influence action by a legislative body.

13. May community foundations engage in or fund lobbying activities?

Community foundations that are public charities may, if they have elected under section 501(h) of the Code, engage in or fund lobbying activities subject to the limitations of section 501(h) and section 4911 or, if they have not, to the extent that the lobbying activity does not constitute more than an insubstantial part of the community foundation's activities.

14. May community foundations make grants to other public charities that are earmarked for lobbying without adverse federal tax consequences?

Community foundations that are public charities may make grants to other public charities earmarked for lobbying so long as the amounts actually earmarked for lobbying are taken into account under the applicable limitation on lobbying expenditures by the community foundation noted in the response to Question 13.

15. May community foundations engage in nonpartisan election-related activities (activities that do not constitute political campaign intervention within the meaning of section 1.501(c)(3)-1(c)(3)(iii) of the regulations) including voter registration, "Get Out the Vote" drives, voter education projects and candidate forums?

Community foundations may engage in non-partisan election-related activities such as voter registration, "Get Out the Vote" drives, voter education projects and candidate forums, provided they do not constitute political campaign intervention under section 501(c)(3) of the Code. Regarding voter registration activities in particular, community foundations that are not private foundations are not required to meet the standards of section 4945(f).

16. In contrast to public charities, private foundations are subject to limitations under section 4945(d)(2) of the Code on funding nonpartisan "voter registration drives." For purposes of the limitations, does the phrase "voter registration drive" include nonpartisan election-related activities other than registering voters, including "Get Out the Vote" activities, voter education projects and candidate forums?

No.

We believe this general information will be of assistance to you. This letter, however, is not a ruling and may not be relied on as such. If you have any questions, please feel free to contact the person whose name and telephone number are listed in the heading of this letter.

Sincerely,

Judith Kindell

for Joseph J. Urban
Manager, Exempt Organizations
Technical Guidance & Quality Assurance

cc: Thomas A. Troyer
Marcus S. Owens
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Washington, DC 20005

Key Issues with Self-Dealing

September 11. 2024

Celia Roady
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WHAT IS SELF-DEALING?

Section 4941 imposes excise taxes on a "disqualified person" who engages in an act of self-dealing with a private foundation, and on any "foundation managers" who approve the act knowing it to be self-dealing

- Applies to direct self-dealing and indirect self-dealing through a controlled intermediary
- State law includes a prohibition on self-dealing that is the same as the prohibition described in Section 4941 but does not include the same excise tax penalties
- Violations can be enforced by the Internal Revenue Service and/or the state attorney general, although the penalties may be different

WHO ARE DISQUALIFIED PERSONS?

Disqualified persons (DPs) are defined to include the following:

- Foundation directors, trustees and officers (including anyone who has the responsibilities of an officer even without the title)
- Substantial contributors, including owners of more than 20% of the voting stock (if a corporation), profits interest (if a partnership) or beneficial interest (if a trust) that is a substantial contributor
- Family members of substantial contributors, including ancestors, lineal descendants, and their spouses but not siblings
- Corporations if more than 35% voting stock is owned by one or more disqualified persons, partnerships if ownership is more than 35% profits interest, and estates/trusts if beneficial interest is more than 35%
- Government officials (see discussion below)

WHO ARE FOUNDATION MANAGERS?

Foundation managers are defined to include the following:

- Foundation directors, trustees and officers
- Persons who have powers and responsibilities similar to those of a director, trustee or officer even without the title, if they have final authority over the act or failure to act determined to be self-dealing, whether or officially or effectively

WHAT ACTS ARE DEFINED AS SELF-DEALING?

Section 4941 defines the following acts as self-dealing:

- Sale, exchange or leasing of property between a foundation and DP
  - Exception for leases from DP to foundation at no cost
- Loans between foundation and DP
  - Exception for loans from DP to foundation at no cost
- Furnishing of goods, services or facilities between foundation and DP
  - Exception for furnishing by DP to foundation for no cost
- Payment of compensation by foundation to DP
  - Exception for reasonable compensation for personal services
- Transfer or use of income or assets of foundation by DP
  - Exception for certain incidental benefits

WHAT ACTS ARE DEFINED AS SELF-DEALING? (con't)

Section 4941 also defines self-dealing to include certain transactions with government officials

- This includes payments or expense reimbursement to government officials
  - Exception for contributions/gifts of $25 or less per year
  - Exception for reimbursement of domestic travel to attend foundation-related conferences and events not to exceed actual transportation costs plus 125% of applicable government per diem
  - Exception for job offers made within final 90 days of government employment
  - Penalties are imposed on government officials only if they engage in the act knowing it to be self-dealing

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WHO IS A GOVERNMENT OFFICIAL?

The definition of government official under Section 4946 includes the following positions:

- Elected officials in the executive or legislative branch of the U.S. government
- Presidential appointees in the executive or judicial branch of the U.S. government
- Other executive, legislative, or judicial branch positions listed in Schedule C of rule VI of the Civil Service Rules or that pay compensation at or above the base for the Senior Executive Service
- Positions in the House or Senate with annual compensation of $15,000 or more
- Elected or appointed positions in the executive, legislative, or judicial branch of the government of a state, political subdivision, the District of Columbia, or a U.S. possession with annual compensation of $20,000 or more
- Personal or executive assistants to any of the foregoing

WHAT ARE THE PENALTIES FOR VIOLATIONS?

Section 4941 imposes a 10% excise tax on the disqualified person for each act of self-dealing, and a 5% excise tax on foundation managers who knowingly approved the act

- The foundation manager tax is capped at $20,000 per act and imposed on a joint and several basis
- If the act is not corrected by undoing the act in specified ways, there is a 200% excise tax on the DP and a 50% excise tax on the foundation manager
- The additional foundation manager tax is also capped at $20,000 per act and imposed on a joint and several basis
- There is no self-dealing tax imposed on the foundation, but the IRS typically treats an act of self-dealing as a taxable expenditure and imposes a tax on the foundation under Section 4945
- Violations of the self-dealing rules are also violations of state law and can be enforced by the state attorney general

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DOES CO-INVESTMENT VIOLATE SELF-DEALING?

For many years, Treasury/IRS have included a project on their work plan to provide guidance on co-investment activity between foundations and DPs

- The origins of this project are a series of private letter rulings in which the IRS ruled that various types of co-investment between foundations and partnerships in which DPs held substantial interests, including partnerships that were DPs, did not constitute self-dealing. This positions was consistent with the excess business holding rules, which permit foundations to invest in partnerships alongside DPs within certain limits
- Around 2010, the IRS stopped issuing favorable private letter rulings but did not revoke existing rulings
- Many foundations have co-invested in partnerships or LLCs with DPs in reliance on the old private letter rulings, but foundations are on notice that the IRS might issue contrary guidance in the future
- Co-investments in partnerships that are themselves DPs because DPs own more than 35% profits interests seem particularly risky

WHAT ARE COMMON EXAMPLES OF SELF-DEALING?

- Improper family office expense sharing, including charging foundation for compensation for services that are not considered “personal services”
- Foundation payment for spousal or family travel without adequate business purpose
- Foundation payment of legally binding pledges made by disqualified persons
- Improper expense reimbursement/use of foundation credit card for personal expenses
- Board or officer compensation/fringe benefits that are not properly documented as reasonable
- Foundation payment for tickets for events used by non-foundation persons
- Payment of expenses of government officials to attend non-qualifying foundation events

Key Issues with Self-Dealing

September 11. 2024

Celia Roady
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KEY ISSUES WITH EXCESS BUSINESS HOLDINGS

James K. Hasson, Jr.
Hasson Law Group, LLP
September 14, 3024

I. OVERVIEW

A. Meaning of "Business Holdings" for Purposes of the Limitation or Prohibition on "Excess Business Holdings"
   1. Corporate Entity
      a. Voting Stock: Directly subject to limitation; generally allowed amount is 20% of the outstanding voting stock less the percentage held by disqualified persons; potentially, 35% if certain conditions are met.
      b. Non-Voting Stock: Permitted in any amount so long as disqualified persons hold 20% or less of voting stock. Regulations section 53.4943-3(b)(2).

I. OVERVIEW

2. Partnership-Type Entity
    a. Profits Interest: Treated same as voting stock in a corporation.
    b. Capital Interest: Treated same as non-voting stock in a corporation.
3. Proprietorship: Prohibited for a private foundation.

I. OVERVIEW

4. Attributed Holdings: Business interests owned by a corporation, partnership, trust or other entity are deemed held proportionately by its shareholders, partners or beneficiaries. Statutory writers failed to recognize the difficulty, if not impossibility, a foundation would encounter in discovering such information from a widely-held business interest.

I. OVERVIEW

B. Disqualified Person Relevance

1. Aggregation of Holdings of Foundation and Disqualified Persons: If disqualified persons hold maximum percentage allowed, foundation may hold none, subject to minimum 2% noted below.
2. Ability to Ignore Holdings of Disqualified Persons: Regardless of the holdings of disqualified persons, the foundation is allowed a 2% minimum holding amount.
3. The 2% permitted holdings is actually no more than 2% of voting stock and no more than 2% of the value of all outstanding stock, whether voting or non-voting.

I. OVERVIEW

3. Irrelevance of Disqualified Persons In a Proprietorship.
4. Identification of Disqualified Persons; same as for self-dealing and taxable expenditure provisions.

I. OVERVIEW

C. Enforcement Through Excise, or Penalty, Taxes

1. Tax Liability: Only foundation is subject to penalty.

2. Tax Amounts: Tax of 10% per year on value of excess business holdings, with 200% tax if not disposed of within permitted period.

3. Tax Reporting: Form 990-PF asks whether foundation had 2% or more direct or indirect "interest" in a business; if "yes," Form 4720 is to be filed.

II. Exclusions

A. "Passive Investment" Exclusion: Business enterprise does not include "functionally related business" or a business essentially generating only passive source income such as dividends, interest, rent, royalties or capital gains.

B. PRI Exclusion: A program-related investment as defined in Code section 4944(d) is not subject to limitation.

III. CONTRIBUTED BUSINESS HOLDINGS

A. Tiered Holdings Periods

1. Historical Tiers: Largely irrelevant now, but extremely important in years immediately after 1969. Holding periods that were allowed generally expired in 1979, 1984, or 1989, depending on percentages of entity ownership, but it is conceptually possible that some "grandfathered" holdings still exist due to unresolved judicial proceedings or trust distributions.

III. CONTRIBUTED BUSINESS HOLDINGS

2. Newly-Created Business Holdings
   a. Basic Five-Year Rule: Excess business holdings that arise due to a contribution to the foundation ("other than by purchase by the private foundation or by a disqualified person") are allowed to be held by the foundation for five years, using the construct that the foundation's holdings during that five-year period are treated as held by disqualified persons rather than by the foundation.

III. CONTRIBUTED BUSINESS HOLDINGS

b. Discretionary Extension: The IRS is given the statutory authority to extend the five-year period for up to five additional years if the gift is unusually large or complex, diligent efforts have been made to dispose of the holdings, and a feasible plan for disposing of the holdings during an extended period is shown to the IRS for approval.

IV. PURCHASED BUSINESS HOLDINGS

A. No Five-Year Disposition Period.

B. Limited Disposition Period

1. If foundation acquires EBH other than by purchase by the

foundation, foundation has 90 days to dispose of EBH without penalty, measured from the day the foundation knows or has reason to know of the creation of EBH.

2. Same result if foundation purchases a business interest but did not know or have reason to know of prior purchases by disqualified persons.

IV. PURCHASED BUSINESS HOLDINGS

3. The 90-day period is extended to the extent necessary to comply with federal or state securities laws.

4. Disposition must be by foundation, not disqualified persons. Regulations section 53.4943-2(1)(ii).

V. TRANSFORMED BUSINESS HOLDINGS

A. Reorganization to Solve EBH Problem. An example is given by Private Letter Ruling 201220037 (2/24/2012), where a charitable organization and its disqualified persons owned a company investing in and managing commercial real estate, including retail business properties that were conceded not to generate passive income. The IRS approved of a plan for restructuring the company by selling active business interests or restructuring operations to convert active business income to passive income, eventually resulting in elimination of EBH by fitting into the exception for interests in a passive business.

V. TRANSFORMED BUSINESS HOLDINGS

B. Reorganization Undertaken Without Regard for Foundation's Holdings: Generally, an increase in a foundation's holdings as a result of a "readjustment" is treated as not occurring by a purchase by the foundation unless the foundation already had EBH. Regulations section 53.4943-6(d). This gives the foundation 5 years to dispose of the EBH.

C. Under the Regulations, a "readjustment" includes a merger, consolidation, recapitalization, redemption, acquisition of stock or assets, and similar transactions.

VI. PROTECTIVE MEASURES

A. Identify and educate disqualified persons.

B. Seek cooperation from disqualified persons through use of periodic questionnaires.

C. Inform disqualified persons of any foundation holdings that exceed 2% by vote or value of interests in a business that is not clearly excluded and request confirmation of no (or limited) holdings of same business by disqualified persons.

D Highlight issue in annual review of Form 990-PF with directors/trustees and officers of the foundation.

KEY ISSUES WITH EXCESS BUSINESS HOLDINGS

James K. Hasson, Jr.
Hasson Law Group, LLP
September 14, 3024

WHAT PRIVATE FOUNDATIONS NEED TO KNOW ABOUT DAFs

James K. Hasson, Jr.
Hasson Law Group, LLP
September 12, 3024

I. WHAT IS A DAF?

A. A Donor Advised Fund ("DAF") is a restricted fund held by a charitable organization ("sponsor") other than a private foundation that allows the donor or donor designees to provide advice to the sponsor as to the use or investment, or both, of the restricted funds.

B. DAFs have become a substantial tool for charitable giving by individuals and other donors, as well as by foundations.

I. WHAT IS A DAF?

C. There are more DAFS than private foundations, but they hold far fewer assets than private foundations.

D. In the aggregate, DAFS pay out in each year a far higher percentage of their asset value than do private foundations, usually around 24%.

II. WHY ARE DAFs RELEVANT?

A. Simplicity
B. Absence of Private Foundation Investment Income Tax and Restrictions
C. Better Income Tax Deduction for an Individual Donor
D. Privacy
E. Negative Considerations—Existing Law
F. Ownership and Control of Assets
G. Perhaps a Limited Period for Donor Advice
H. Perhaps a Limited Opportunity for Investment Guidance

II. WHY ARE DAFs RELEVANT?

F. Potential Negative Legislation

1. Proposed Legislation: S. 1981 ("ACE Act"), introduced 6/9/2021.
2. President Biden's Proposals
3. Bipartisan House Bill
4. The Criticisms Of Donor Advised Funds—Anonymity; Spend Now, Not Later; Financial Power And Political Influence
5. Philanthropic Community's Divisions—Supporters, Opponents, And Compromisers
6. Current Status

III. WHY ARE DAFs CRITICIZED?

A. Substantial amounts of DAF funds are held by charitable organizations affiliated with major investment management firms, such as Fidelity and Vanguard, leading some reformers to dismiss them as merely another line of business for these money managers.

B. The opponents of DAFs contend that DAFs are mere "holding tanks" for future use, allowing DAFs to avoid spending anything on actual charitable programs.

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III. WHY ARE DAFs CRITICIZED?

C. DAF opponents have been able to identify isolated instances in which a DAF has not made any distributions. This use of isolated incidents is the same strategy as that used successfully against private foundations decades ago. These isolated instances are now used to justify attempts at wholesale elimination of the DAF as a giving vehicle.

D. Many DAF critics also oppose DAFs on the basis that DAFs hide the identity of their real donors and real beneficiaries from the public and so should therefore be banned.

IV. CAN A FOUNDATION CONTRIBUTE TO A DAF?

A. A private foundation may contribute to the sponsor of a DAF for funding the DAF so long as the sponsor is described in Code section 4945 (d)(4) and 4942(g)(4)(A) (i) or (ii) as a "public charity" described in section 509(a)(1), (2) or (3), except for a non-functionally integrated type III supporting organization or a type I or II supporting organization controlled by a disqualified person.

B. A private foundation that contributes to the sponsor of a DAF may be given donor advisory privileges, at the discretion of the sponsor, at least under current law.

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IV. CAN A FOUNDATION CONTRIBUTE TO A DAF?

A. A DAF is not prohibited from contributing to a private foundation, but the requirements for doing so are likely too burdensome for most sponsors. Fidelity Investments Charitable Gift Fund, for example, will not grant to a private foundation other than an operating foundation.

B. Internal Revenue Code section 4966 penalizes with a 20% tax any distribution from a DAF to a natural person or, unless expenditure responsibility is exercised, to other specified organizations, including a private non-operating foundation which is not a "pass through" foundation. It appears likely that few DAF sponsors will be willing to exercise expenditure responsibility for a contribution from a DAF to an ordinary non-operating (grantmaking) foundation, but some circumstances can be identified where that might not be the case.

V. CAN A DAF CONTRIBUTE TO A FOUNDATION?

C. In addition, any payment from a DAF that is found to be compensatory to a donor to the DAF, a donor advisor, or a related person is subject to the excess benefits tax of Code Section 4958.

VI. CAN A DAF AND A FOUNDATION COOPERATE VII. IN GRANT-MAKING?

A. No apparent general obstacle exists, so long as independence of action is both real and documented.

B. No grants to individuals by DAF.

C. No sanction for program related investments by DAF.

VII. WHAT LEGISLATIVE OR ADMINISTRATIVE CHANGES TO DAFS WOULD BE LOGICAL?

A. Disclosure Obligations

B. Limited Donor Advice Period

C. Mandatory Distribution Requirements

WHAT PRIVATE FOUNDATIONS NEED TO KNOW ABOUT DAFs

James K. Hasson, Jr.
Hasson Law Group, LLP
September 12, 3024

Fiscal Sponsorship for Private Foundations

Rosemary Fei, Adler & Colvin
September 12, 2024

What is a fiscal sponsorship?

Public charity (Sponsor) assists someone wishing to carry out a set of charitable activities (Project).

Fiscal sponsorship allows Project to benefit from grants from private foundation (PF) funders to Sponsor, which Project cannot otherwise access. Sponsor can use funds to support Project.

Wide range of possible arrangements with varying legal implications.

Why use a fiscal sponsorship?

Individual donors want charitable deductions, and PFs prefer to make grants to public charities, but Project is not conducted by a public charity:

- May be conducted by individual(s), union, trade association, business.
- May be conducted by a new nonprofit not yet recognized by IRS.
- Project may be of short duration, even a single event, or an urgent need.
- Project initiators may not be sure whether the Project will succeed.

Project staff may lack skills or bandwidth for handling operations.

Two models of fiscal sponsorship – Who is the grantee?

Model A: Project as In-house Staff Project	Model C: Project as Separate Entity
• No separate legal existence	• Separate legal existence
• Project initiators become employees/independent contractors of Sponsor	• Relationship can range from simple grants from Sponsor to Project, to extensive Sponsor oversight of Project's activities and strict control of Project's finances
• *Sponsor has total liability for Project, needs corresponding oversight/control*	• *Sponsor liability varies depending on level of control over Project*

So what's the problem? "Earmarking"

SUPPOSE: PF makes a grant to Sponsor, which then re-grants the funds to the person conducting the Project. If IRS decides PF "earmarked" its grant for the ***person*** conducting the Project, it will treat PF as having made that grant directly to that person. BUT:

- That person is not a public charity.
  - PF grants to anyone not a public charity are prohibited taxable expenditures.
    - Unless PF exercised "expenditure responsibility" (ER)*
      - But why would PF have exercised ER when it thought it was making a grant to Sponsor, a public charity?
        - If grant deemed earmarked, PF has a taxable expenditure.

THEREFORE: PF must avoid earmarking its grant to Sponsor for any other ***entity***. Sponsor must have discretion/control over use of grant funds for the ***specified purposes***.

Note: Earmarking risk is especially high if PF has discussed funding with persons who will run the Project before Sponsor is in place!

** ER requires (1) a pre-grant inquiry by PF to vet the grantee, its personnel, and the proposal; (2) a written grant agreement containing specific provisions; and (3) reporting the grant on PF's Form 990-PF. ER isn't hard, but you have to know you have to do it.*

The 9-step Solution to Earmarking

Step 1: Person conducting Project presents a written grant proposal describing Project to Sponsor.

Step 2: Sponsor evaluates the Project proposal. Is it charitable? Does it further Sponsor's purposes?

Step 3: Sponsor's Board reviews and approves sponsorship of Project, documenting its decision in minutes/resolutions.

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The 9-step Solution (cont'd)

Step 4: Sponsor and person conducting Project sign written Project Grant Agreement.

Step 5: Sponsor and/or Project staff solicit funds from PF, clearly noting Sponsor's control in Project Grant Agreement.

Step 6: PF and Sponsor enter into PF Grant Agreement, earmarking PF's grant for specified charitable purposes and activities that track the Project proposal.

The 9-step Solution (cont'd)

Step 7: Sponsor receives a grant from PF, and uses it to make a grant to the person conducting the Project under the Project Grant Agreement.

Step 8: Person conducting the Project makes periodic written reports to Sponsor in compliance with the Project Grant Agreement.

Step 9: Sponsor makes any necessary reports to PF under the Private Foundation Grant Agreement.

Making a grant to a fiscal sponsor: Questions to consider

- Is the Project housed in a separate legal entity from the Sponsor?
- What is the current legal entity and tax status of the people running the Project?
- Why use a fiscal sponsor? What value is the Sponsor adding?
- Do the Sponsor and the people running the Project understand their relationship, and have they documented it in a written Project Grant Agreement?
- What is the Sponsor's administrative fee?
- Do the persons running the Project intend to become a separate public charity? Or how else might the Sponsor's relationship to the Project evolve over time?

Other issues

People running the Project need to understand their organization's legal and tax status.

Organization must either file tax returns as a taxable entity or apply for tax exemption.

PF may want to help those running the Project with decisions about legal form or implementing eventual spin-off from Sponsor.

Alternatives to using a Fiscal Sponsor

Make grant directly to the organization running the Project, exercising expenditure responsibility.

- Makes sense where the organization expects to receive IRS determination letter shortly.
- Grant will count as a qualifying distribution unless the organization is also a PF.
- Keeping an experienced Sponsor in the picture may still be ideal if the new entity needs help with organization and administration.

Conduct the Project as a direct charitable activity of the PF.

- Advantage = complete control.
- Disadvantage = complete liability.
- Disadvantage = other private foundations are less likely to want to fund a project housed at a private foundation.

Questions?

Fiscal Sponsorship for Private Foundations

Rosemary Fei, Adler & Colvin

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Impact Investing: Case Studies of MRIs and PRIs

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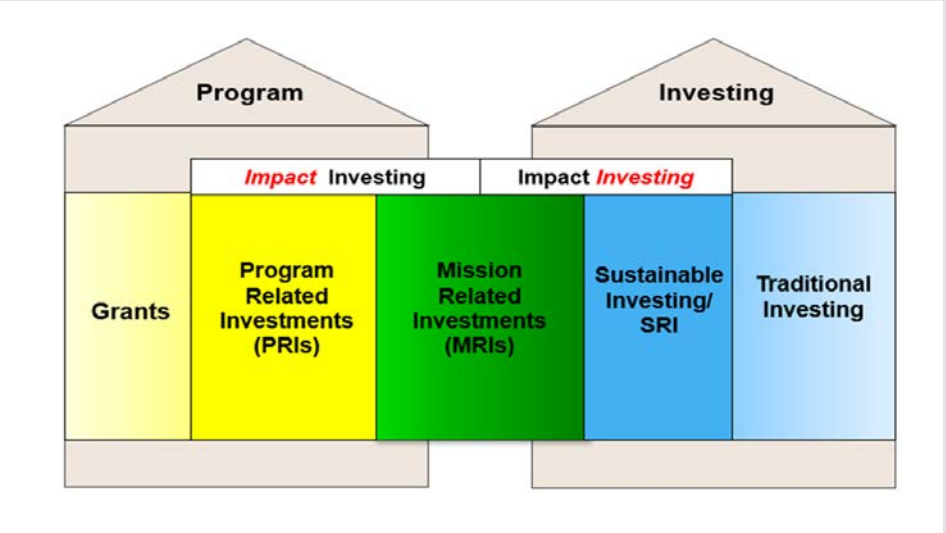
Impact Investing

- Impact investing allows private foundations to align mission with their investment strategies
- Impact investing can take several forms:
  - Socially-Responsible Investments (SRIs) – use of screens to include/exclude categories
  - Mission-Related Investment (MRIs)
  - Program-Related Investments (PRIs)
- This outline focuses on MRIs and PRIs, including:
  - Part 1: Laws and regulations, both federal and state, governing MRIs and PRIs
  - Part 2: Case studies of MRIs and PRIs

Foundation Impact Investing Spectrum



Mission-Related Investing

- Mission-related investing allows foundations to leverage their investment assets to further their charitable purposes
- MRIs are subject to federal and state legal requirements
  - MRIs are subject to the jeopardy investment rules under Section 4944 of the Internal Revenue Code
  - MRIs are subject to state laws governing the investment of charitable funds based on the Uniform Prudent Management of Institutional Funds Act (UPMIFA)

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Federal Tax Regulation of MRIs: Section 4944

- Section 4944 imposes an excise tax on a foundation that invests "any amount in such manner as to ***jeopardize the carrying out of its exempt purposes***" (a "jeopardizing investment")
  - First tier tax of 10% on foundation for each year investment is outstanding
  - Second tier tax of 25% on foundation if investment not removed from jeopardy after initial tax
  - First tier tax of 10% on foundation manager for each year, up to a maximum of $10,000, if foundation manager participated in the making of the investment knowing that it would jeopardize carrying out the foundation's exempt purposes
  - Second tier tax of 5% on foundation manager, up to a maximum of $20,000
- Investment is a jeopardizing investment if foundation managers fail to exercise ordinary care and prudence in providing for the financial needs of the foundation

IRS Examples of Jeopardizing Investments

- Example 1: Investment in common stock of a corporation with a promising product and uneven earnings record that has never paid a dividend and is widely reported to be seriously undercapitalized (Treas. Reg. 53.4944-1(c) Ex. 1)
  - However, if the foundation makes the investment conditional on the corporation's receipt of other concurrent investments sufficient to satisfy its capital requirements so that it may overcome its uneven earnings record, the investment will not be a jeopardizing investment (Treas. Reg. 53.4944-1(c) Ex. 2)
- Example 2: Providing **venture** capital to a new corporation that will produce a promising new product that must compete with an established alternative product that serves the same purpose (Treas. Reg. 53.4944-1(c) Ex. 1)
  - However, not a jeopardizing investment if management has a demonstrated capacity for getting new businesses started successfully and the investee has received substantial orders for the product (Treas. Reg. 53.4944-1(c) Ex. 2)

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State Regulation of MRIs: UPMIFA

- UPMIFA regulates MRI investments
  - UPMIFA is a uniform act that imposes requirements when managing and investing charitable funds
  - Has been adopted in 49 states
  - Pennsylvania has not adopted UPMIFA but imposes its own prudence requirement
- UPMIFA requirements when managing and investing an endowment:
  - Consider the charitable purposes of the institution and the purposes of the endowment
  - Act in good faith
  - Use care an ordinarily prudent person in a like position would exercise under similar circumstances
  - Consider specific enumerated factors in making investments

UPMIFA Factors for Consideration

- UPMIFA lists the following factors for consideration when making investments:
  - General economic conditions
  - Possible effect of inflation or deflation
  - Expected tax consequences, if any, of investment decisions or strategies
  - Role that each investment plays within overall investment portfolio of the fund
  - Expected total return from income and the appreciation of investments
  - Other resources of the institution
  - Needs of the institution to make distributions and preserve capital
  - **An asset's special relationship or value, if any, to the charitable purposes of the foundation**
- State AGs have stated publicly that documentation of prudent investment process and mission relationship is key to demonstrating UPMIFA compliance for MRIs

IRS Notice 2015-62: Aligning Section 4944 and UPMIFA

- In 2015, the IRS issued Notice 2015-62, providing guidance on the standards under Section 4944 for investments made for charitable purposes
  - Aligns rules under Section 4944 with UPMIFA/state law standards
  - Confirms that foundation managers can consider, as one factor, whether the investment furthers the foundation's charitable purpose
  - Cites UPMIFA investment standards
- Notice 2015-62 states that: "a private 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 furthers 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"

Practical Considerations In Designing MRI Programs

- Initial Planning and Program Design
  - Determine goals and success measures
  - Determine how investment and program staff will collaborate
  - Amend investment policy (if necessary) to include UPMIFA standards, including consideration of compatibility of investments with charitable purposes
  - Define process for identifying, reviewing and approving MRI investments
  - Establish form of documentation to show compliance with UPMIFA and Section 4944
- Implementation
  - Integrate review and approval of MRIs into regular investment review and approval process
  - Determine process for monitoring MRIs and for measuring mission impact

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Program-Related Investments

- PRIs allow foundations to make charitable investments treated, for most purposes, like grants
- PRIs are treated as qualifying distributions under Section 4942 but must be added to the minimum distribution requirements in the year repaid
- PRIs are exempt from the excess business holding rules under Section 4943
- PRIs are exempt from the jeopardy investment rules under Section 4944 if they meet specific requirements
- PRIs made to organizations other than public charities are subject to the expenditure responsibility requirements under Section 4945
- PRIs are excluded from the definition of "institutional funds" under UPMIFA

Common Types of PRIs

- PRIs can take many forms, including any of the following:
  - Below market loans
  - Equity investments in public or private companies
  - Convertible debt or equity
  - Loan guarantees, including guarantees of loans by commercial lenders
    - Note: guarantees will be treated as qualifying distributions only if called and paid
- PRIs can be made to public charities, private foundations, public and private companies, LLCs and limited partnerships, and investment funds

Federal Tax Regulation of PRIs: Section 4944

- An investment that is a PRI is NOT a jeopardizing investment
- PRIs must meet three requirements:
  - The primary purpose must be to accomplish charitable purposes
  - No significant purpose can be the production of income or the appreciate of assets
  - No purpose can be for lobbying or political campaign intervention
- PRIs can be made to charitable or non-charitable organizations
  - In 2016, the IRS issued final regulations containing nine new examples showing that PRIs can fund a wide range of charitable programs, including commercial businesses that serve as intermediaries to reach the intended charitable beneficiaries
- The determination as to whether a PRI constitutes a jeopardizing investment is made at the time of the PRI and not based on hindsight

New PRI Regulations: Examples

- New PRI regulations illustrate the following permissible PRI investment terms and structures:
  - A PRI recipient is required to distribute drugs to the poor at affordable prices and may also sell the drug to other individuals at a market rate (Ex. 11)
  - A PRI recipient is required to promptly (after necessary patent protection) publish the results of research to cure a disease (Ex. 11)
  - An equity investment in a subsidiary of a commercial enterprise where the subsidiary was established to carry on the activities that further charitable purposes (Ex. 11)
  - A potentially high rate of return if the PRI recipient is successful in its business (Ex. 12)
  - An equity investment (or loan with an equity component) in a commercial business whose business activity will support the charitable purposes (Ex. 12 and 13)

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New PRI Regulations: Examples (cont'd)

- A foundation holds stock in a PRI recipient even after the PRI recipient's profitability, or lack thereof, is established (Ex. 13)
- A loan to a distressed business enterprise that will enable it to continue its business operations
(Ex. 14)
- A loan to poor individuals that will enable them to start small businesses (Ex. 15)
- A loan to a business where the loan proceeds are required to be used for training the poor suppliers of the borrower (Ex. 16)
- A credit support which may be collateralized (Ex. 18) or subject to a reimbursement agreement
(Ex. 19)

New PRI Regulations: Guiding Principles

- The IRS posted seven guiding principles on its website the same day final regulations were issued:
  - An activity conducted in a non-US country furthers an exempt purpose if the same activity would further an exempt purpose if conducted in the United States
  - The exempt purposes served by a PRI may include any charitable purposes and are not limited to situations involving economically disadvantaged individuals and deteriorated urban areas
  - The recipients of PRIs need not be within a charitable class if they are the instruments for furthering an exempt purpose
  - A potentially high rate of return does not automatically prevent an investment from qualifying as a PRI
  - PRIs can be achieved through a variety of investments, including loans to individuals, tax-exempt organizations and for-profit organizations
  - A credit enhancement arrangement may qualify as a PRI
  - A private foundation's acceptance of an equity position in conjunction with making a loan does not necessarily prevent the investment from qualifying as a PRI

New PRI Regulations: Guiding Principles (cont'd)

- Additional principles discussed in the preamble to the final regulations include the following:
  - PRIs often involve some private benefit to one or more persons that are not part of a charitable class
  - This may include the PRI recipient itself and this is permissible so long as the private benefit is incidental to the PRI's exempt purposes
  - Foundations may use a PRI to assume certain risks (e.g., in a deposit agreement or a guarantee) to catalyze the entry of private investment capital to further exempt purposes

Federal Tax Regulation of PRIs: Section 4945

- Section 4945 requires foundations to exercise "expenditure responsibility" over PRIs made to non-charitable organizations
- Expenditure responsibility involves several steps:
  - Conducting a pre-grant inquiry to determine that the PRI recipient can be expected to carry out the charitable activity for which the PRI will be made
  - Entering into a written PRI agreement meeting certain requirements throughout the term of the PRI, including the following:
    - Requiring the PRI recipient to provide annual narrative and financial reports
    - Requiring the PRI recipient to maintain books and records about the PRI and make them available for inspection upon reasonable request
    - Requiring the PRI recipient to repay the investment if the charitability requirements are not met
  - Obtaining reports on the use of the PRI funds
  - Making reports to the IRS on Form 990-PF

Practical Considerations in Designing a PRI Program

- Initial planning and program design
  - Determine goals and success measures
  - Determine how investment and program staff will collaborate
  - Define process for identifying, reviewing and approving PRIs
    - Prepare a PRI term sheet to use in initial discussions
    - Require investee to comply with charitable indicators and to provide additional duties to meet the foundation's programmatic needs
    - Establish a process for exercising expenditure responsibility, including the preparation of appropriate form of documentation
    - Consider obtaining a legal opinion for PRIs to noncharitable organizations
- Implementation
  - Develop a system for monitoring the PRI recipients' compliance with PRI agreements
  - Collect data from PRI recipients to evaluate success in achieving intended objectives

Why Use PRIs / MRIs?

- They extend range of tools for accomplishing charitable purposes. Grants are a tool, but not the only tool, available to grantmakers to achieve the desired impact
- In some circumstances, a loan can be as effective as a grant in achieving charitable impact. And if loaned funds can be repaid, they can be loaned again (or granted) to others, extending the charitable impact
- A PRI or MRI may draw additional capital to the charitable work
- Debt or equity investments can help allocate financial gains resulting from the funded activity. If a for-profit organization is funded, an investment (rather than a grant) may help mitigate private benefits
- PRIs/MRIs may result in collateral benefits that grants alone cannot provide

MRI Case Study 1

- Private foundation has a grant-making program that focuses on improving learning outcomes for at-risk students, including K-12 and post-high school learning opportunities that prepare students for careers
- Foundation believes that a key underutilized area of focus is on EdTech and how engaging and learning-rich digital tools can help at-risk students at all levels
- Foundation makes an investment in Owl Ventures, a venture capital company that invests in companies that offer EdTech solutions for students and schools across the education spectrum
- Other investors include college and university endowments, private foundations, family offices, and other private equity investors
- See https://www.owlvc.com/outcomes.php; https://owlvc.com/news-owl-ventures-fund-v.php

MRI Case Study 2

- Private foundation has a grant-making program focused on improving health around the world, with particular focus on the developing world
- Foundation recognizes the difficulties for start-up and emerging life science companies to obtain capital to pursue promising but high-risk area technologies
- Foundation makes an investment in Adjuvant Capital, a venture capital fund that invests in promising life science technologies for high-burden public health challenges
- Investors include the Gates Foundation, Anthos Fund & Asset Management, Beacon Pointe Advisors, CDC Group, the Children's Investment Fund Foundation, Dalio Philanthropies, the Doris Duke Charitable Foundation, ELMA Investments Ltd., the Ford Foundation, the International Finance Corporation (IFC), the John D. and Catherine T. MacArthur Foundation, Global Health Investment Corporation (with funding from the Government of Germany through KfW), Laerdal Million Lives Fund, Merck, Novartis, RockCreek, Sonanz, and The Sorenson Impact Foundation
- Some investors made MRI investments; some made PRI investments
- See https://adjuvantcapital.com/

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MRI Case Study 3

- Private foundation has a grant-making program focused on urban issues and ways to support healthy, vibrant cities
- Foundation believes that private capital investment is critical to the development of solutions to many problems facing cities, including climate resilience, transportation, public health and safety, food systems, and civic/governmental technology
- Foundation invests in the Urban Innovation Fund, a venture capital fund that invests in companies that offer solutions to address various problems of cities and increase their livability, sustainability and economic vitality
- See https://www.urbaninnovationfund.com/

PRI Case Study 1

- 501(c)(4), affiliated with 501(c)(3), is formed to promote safe and affordable housing for low-income families and workforce families
  - There are many class B and C apartment buildings that are located in transit zones and in need of renovation
  - These building, with some renovation, can provide unsubsidized housing for low-income families and workforce families that generates positive cash flow
  - The housing can support rebates to residents who pay rent for a period of time
  - The ultimate goal is to demonstrate that unsubsidized rental housing for low income and workforce housing can be a good investment for profit-seeking investors
  - See Renter Wealth Creation Fund, https://www.enterprisecommunity.org/impact-areas/upward-mobility/renter-wealth-creation

PRI Case Study 2

- Private foundation seeks to invest in EdTech solutions to help low income and disadvantaged learners complete a college degree
- The goal is to create a network of academic institutions that can work together, through shared technology, to extend reach and broaden impact. Technology can help institutions embark on innovative solutions to attract and retain the modern-day learner while future-proofing against the dynamic higher education landscape
- Revenue generation potential by charging fees to academic institutions; if concept works, market-based investors may be interested
- See Acadeum https://acadeum.com/

PRI Case Study 3

- Private foundation seeks to invest in drugs and therapeutics to treat Alzheimer's disease
- Foundation invests in pharmaceutical company trying to develop a blood test to accurately detect the potential for plaque in the brain associated with Alzheimer's
- If successful, blood tests would identify which patients could benefit from early drug treatment (also in development)
- Societal benefit would be enormous; very substantial revenue generation potential if tests are approved by the FDA and covered by Medicare
- See https://c2n.com/news-releases/cn-diagnostics-announces-follow-on-investment-from-ghr-foundation-as-it-builds-on-success-in-novel-diagnostics-to-aid-in-alzheimers-disease-fight

Clean Energy Project Financing Case Study

- Exempt organization plans to install credit eligible clean energy property (under 1 Mw capacity) to power a building in an "energy community." It also received an allocation of the low-income community bonus credit. Project cost is $300,000. Total potential credit is $150,000 (50% * $300,000)

Solar Project Budget	300,000	
Less: Federal Credit	150,000	$300,000 * 50%
Net cost	150,000	

Clean Energy Project (cont'd)

- Annual energy bill is $30,000 currently; with the solar project, the annual electricity bill will be $5,000, freeing up $25,000 per year in operating costs for the life of the project. These operating savings could be used to pay off a loan for the project costs – and then could be used for charitable purposes

	1	2	3	4	5	6	7 +
Debt	150,000	125,000	100,000	75,000	50,000	25,000	0
Savings – pay project costs	25,000	25,000	25,000	25,000	25,000	25,000	
Savings – charitable use	0	0	0	0	0	0	25,000

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What's the catch with direct pay tax credits?

- Exempt organization doesn't receive the tax credit cash until:
  - property is placed in service (construction substantially complete)
  - prefiling registration is completed (allow four months)
  - Form 990-T is timely filed electing direct pay in following year (up to 10.5 months after the end of the year placed in service)
  - IRS processes the return (after the due date and after return is filed) and sends the cash (likely the second year following year placed in service)
- Net cost to exempt organization may be only $150,000 – and they may have that available (through reserves, grants, etc.), ***BUT…***
  - The organization needs the full $300,000 to pay contractors up front
  - And the organization may not even have the $150,000

What's the catch? (cont'd)

- Restricted grant "gotcha" – The tax credit amount is reduced if the credit property acquisition is funded by a restricted grant
  - Under the direct pay regulations, if the sum of the restricted grant funding and the otherwise available credit amount exceed the cost of the project, then the credit amount is reduced until there is no excess
  - Therefore, if a project is funded entirely with a grant specifically for the purpose of acquiring the credit property, **no credit is available**
    - Reducing credit amount reduces the aggregate amount of capital available for charitable uses
    - But loans, which are paid back when credits are received, do not reduce credit amounts – so there's more charitable use capital in the aggregate

Clean Energy Project: Grant

- Assume Foundation makes a restricted grant for the project costs of $300,000. Credit would be reduced to zero because the restricted funding plus the potential credit amount would exceed the cost of the project.

	0	1	2	3	4	5	6+
Project Costs	300,000						
Grant	300,000						
Tax Credit	0						
Savings – charitable uses		25,000	25,000	25,000	25,000	25,000	25,000

- If Foundation has $1.2M budget to assist local charities in acquiring clean energy property, it could make property acquisition grants to four charities.

Clean Energy Project: Grant + Credit Loan

- If Foundation makes a zero-interest PRI bridge loan of $150,000 to be paid from the tax credit proceeds and a restricted grant of $150,000, the tax credit amount is not reduced. Charity still gets clean energy property at no cost and charity still saves $25,000 annually in operating costs.

	0	1	2	3	4	5	6	7+
Project Costs	300,000							
Bridge Loan – two years	150,000	150,000	0					
Grant	150,000							
Tax Credit			150,000					
Savings - charitable use	0	25,000	25,000	25,000	25,000	25,000	25,000	25,000

Clean Energy Project: Grant + Credit Loan (cont'd)

- Foundation perspective: when PRI bridge loan is paid back, the amount is added to the distributable amount for that year. Assume Foundation made bridge loans and grants for energy property to four charities in year zero. When paid back in year two, it funded two more charities' projects. In year four, after repayment, it funded another project. And it could provide grant funding for one more project in year six (assume charity self-funded the other half). Up to eight charities could get clean energy property worth $2.25M for the same $1.2M budget

	0	1	2	3	4	5	6	7+
Bridge Loan – 2 years	600,000		300,000		150,000			
Grant	600,000		300,000		150,000		150,000	
Charity funds							150,000	
Tax Credit - pay loan			600,000		300,000		150,000	

Clean Energy Project: Credit Loan + LT Loan

- Assume the Foundation funds the bridge loan as a PRI and helps the charity secure longer-term financing for the rest of the cost from another lender. Charity would use operating cost savings for the first six years* to pay back the longer term debt.

	0	1	2	3	4	5	6	7+
Project Costs	300,000							
Bridge Loan – 2 years	150,000	150,000	0					
LT Debt: Bank? CDFI?	150,000	150,000	125,000	100,000	75,000	50,000	25,000	0
Savings – pay LT debt		25,000	25,000	25,000	25,000	25,000	25,000	
Tax Credit – pay loan			150,000					
Savings – charitable use	0	0	0	0	0	0	0	25,000

*Interest ignored for simplicity; payback period would be a bit longer with interest.

Clean Energy Project: Credit Loan + LT Loan (cont'd)

- If Foundation could help facilitate debt financing for half of the project costs, it could use all of its $1.2M in year zero to provide bridge loans for eight charities to acquire energy property. When paid back in year two, it could support eight more charities' projects. And eight more in year four. Program could be ended in year six, with grants to eight more charities (instead of bridge loans) and the tax credit amounts they receive in year eight could pay off their loans. 32 charities could get clean energy property worth $9.6M for the same $1.2M budget

	0	1	2	3	4	5	6	7+
Bridge Loan	1,200,000		1,200,000		1,200,000			
Grant							1,200,000	
Debt	1,200,000		1,200,000		1,200,000		1,200,000	
Tax Credit			1,200,000		1,200,000		1,200,000	

Resources on PRIs and MRIs

- Mission Investors Exchange
  - https://missioninvestors.org/
- Sorenson Impact Foundation
  - https://sorensonimpactfoundation.org/wp-content/uploads/2022/06/SIF-MRI-Report-Finalized-Version-reduced.pdf
- SOCAP Global
  - https://socapglobal.com/what-is-impact-investing/
- Council on Foundations
  - https://cof.org/content/impact-investing
- Global Impact Investing Network
  - https://thegiin.org/

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General Counsel Roundtable

Josh Mintz, Ricardo Castro, and Maureen Lawrence

Sample Documents

- El Pomar Foundation Conflict of Interest Policy
- MacArthur Foundation | Expectations for the Conduct of the Directors of Not-for-Profit Organizations
- MacArthur Foundation | Rules of Foundations for New Directors
- MacArthur Foundation | Key Issues for an Incoming Board Chair of a Private Foundation
- MacArthur Foundation | Conflicts of Interest
- Robert Wood Johnson Foundation's Conflict of Interest Policy
- MacArthur Foundation | Suggested Steps for an Effective Search for a New Foundation President

EL POMAR FOUNDATION
CONFLICT OF INTEREST POLICY

Each Trustee and each staff member of El Pomar Foundation shares the responsibility for maintaining the public's trust of the Foundation. This responsibility for fairness and integrity must be fulfilled through individual compliance with the spirit as well as the letter of the law governing private foundations and by careful and thoughtful adherence to a strict code of ethical behavior.

The standards set out in this policy statement are guiding principles, which must be used along with one's good judgment. Overall, the objective of each trustee and senior staff member must be actual *and perceived* honesty, fairness and integrity in all aspects of business and personal conduct with full disclosure – erring on the side of caution – in any situations that are, or may become, conflicts of interest. Conflicts of interest arise when a trustee or senior staff member takes part in a Foundation decision in which he/she may be unable to remain impartial, maintain objectivity or fulfill his/her duty of loyalty in choosing between the interests of the Foundation and his/her personal interests. In some cases, it may be a simple conflict of loyalties. In others, the person concerned (or a relative or partner etc.) has a financial interest in the decision.

Board and staff members of the Foundation are encouraged to play active roles in their communities by serving as board members or otherwise being involved with a wide spectrum of nonprofit organizations. Combined with friendships, family involvements and business relationships, potential conflicts of interest or the appearance of such conflicts will inevitably arise from time to time. It is the Foundation's intention to deal with such conflicts in an open and appropriate manner which includes full disclosure, abstention from voting and proper recording in the corporate records.

With this in mind, El Pomar Foundation has adopted the following policies with respect to members of the Board of Trustees and senior staff:

1. Foundation personnel shall not knowingly take any action, make any statement, take advantage of a vendor relationship or otherwise influence the conduct of the Foundation's affairs in such a way as to confer a financial benefit upon him/her or a member of his/her family or business interest.

2. In the event that there comes before the Board of Trustees or one of its committees a matter for consideration or decision that raises a potential conflict of interest for any Trustee, the Trustee shall disclose the conflict of interest as soon as he/she becomes aware of it and shall abstain from voting on the matter. Such disclosure and abstention shall be recorded in the minutes of the meeting and the presence of the member with a conflict of interest shall not be counted toward a quorum with respect to that matter.

3. In the event that a member of the Foundation board or staff is in doubt regarding a potential conflict of interest, he/she shall seek permission from the Chair of the Board for Trustees or CEO for staff before engaging in discussion and/or voting.

4. Foundation personnel shall disclose to the Secretary of the Board of Trustees all official connections (including connections with family members) with any potential grant applicant as well as affirm that they have adhered to the Foundation's conflict of interest policies including full disclosure of their dealing with the Foundation or its vendors (other than compensation and reimbursement of approved expenses). For those board and staff members who are considered disqualified individuals and must conduct themselves in such a way so as to avoid violating the IRS self-dealing rules, disclosure must also include a list of all family members and related entities which IRS regulations would also consider a disqualified individual.

5. The Secretary of the Board shall declare to the full board that all disclosure statements have been received and that there have been no exceptions to these policies.

EL POMAR FOUNDATION
CONFLICT OF INTEREST DISCLOSURE FOR 2024

Name: _____

I or members of my family serve as staff, officers, directors or trustees of the following charitable and nonprofit organizations:

Organization	Self/family member affiliation

I, or members of my family own more than 1% or are officers or directors of the following for-profit organizations:

Organization	Self/family member affiliation

As a Trustee or officer of the Foundation, I have attached a list of the following family members or entities which would be considered "Disqualified Persons" with respect to the Foundation under the Internal Revenue Code:

- My Spouse
- My Children and their spouses
- My Grandchildren and their spouses
- My Great Grandchildren and their spouses
- Any corporations, Partnerships, Trusts or Estates in which I have greater than a 35% interest

I have received a copy of the current conflict of interest policies adopted by El Pomar Foundation and affirm that I have complied with their provisions including the full disclosure of all dealings direct or indirect, between myself, a member of my family or business interest which would be considered a conflict of interest.

_____ _____

Signature Date

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.

Introduction to the Rules of Foundations for New Directors

Joshua J. Mintz, Vice President and General Counsel
John D. and Catherine T. MacArthur Foundation

The paper introduces the legal issues with which a director of a private foundation should generally be aware. It is not intended as a comprehensive overview of all issues that might confront a private foundation. Private foundations are subject to a complex set of rules and regulations overseen by the Internal Revenue Service. In addition, typically as a not-for-profit corporation (or trust) organized under state law, the foundation is also subject to various State laws and the oversight of the Attorney General.

It is strongly recommended that a private foundation and its directors frequently consult with competent counsel whenever questions arise (and preferably beforehand) and periodically invite counsel to provide briefings on relevant issues and developments in the sector. The costs of counsel can be a consideration in deciding how often counsel should be consulted or even to have in house counsel. As this paper will identify, however, there are many legal pitfalls that a private foundation can confront, and spending a little bit to save the foundation from damages, monetary and reputational, is prudent and, in the author's opinion, worth the cost.

It is not expected that a director be intimately familiar with the rules in all their complexities. A director should, however, be generally aware of the basic concepts and, of course, his/her duties to the foundation. **One of the most important unwritten rule is to ask questions of legal counsel if you are at all uncertain about your duties or an issue**. There is really no question that is too "dumb" to ask. A director should never be in a position if a problem arises of wishing she wished she had asked a question.

A director should all be aware of and have copies of the basic governance documents and policies that are particularly relevant to directors, such as the by-laws, articles of incorporation, charters for Board committees, compensation and expense reimbursement policies if applicable, the code of conduct or conflicts of interest policies applicable to directors and similar documents that may be relevant to the particular foundation.

General Duties of Directors of Not-for-Profit Corporations

Directors of not-for-profit corporations have fiduciary duties similar to the directors of for-profit companies. Each director owes two primary obligations to the corporation that he or she serves: A duty of care and a duty of loyalty. Many not-for-profit commentators also suggest that there is a separate duty of obedience, which is a duty to conform the organization's activities to its charter and applicable law. In for-profit companies, the duties run generally to the corporation and its shareholders; in the case of not-for-profits, the duties run directly to the corporation and derivatively to the general public.

The duty of care requires directors to use that amount of care which an ordinarily careful and prudent person would use in similar circumstances and consider "all material

information reasonably available" in making business decisions.[1] A breach of the duty of care can arise from a board decision that is made in a negligent manner, as well as a board's failure to act to prevent loss to the corporation. Courts in Delaware have focused increased attention on a corporate board's duty to oversee and monitor the corporation and the conduct of its affairs by management.

The duty of loyalty requires directors to act in good faith and solely in the best interests of the corporation. A director should seek to avoid conflicts of interest and, if actual or potential conflicts are present, to disclose the nature of the conflict and abstain from voting on the matter. Decisions made by directors should be independent such that any decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influence. Also implicit in the duty of loyalty is an obligation of each director to maintain the confidentiality of information the corporation treats as confidential and information regarding the board's deliberations.

Each foundation should have a conflicts of interest policy that requires each director to disclose certain relationships to help the foundation address any perceived or actual conflict. Disclosures should be completed on at least an annual basis, and updated whenever relationships change during the course of the year.

Directors of a private foundation also should generally be familiar with certain rules applicable to private foundations arising from the Internal Revenue Code or relevant state law. Some of the more important rules are described below.

Protection Provided to Directors

The risk of claims against foundation directors is considerably lower than the risk to directors of public or private for-profit companies. Nevertheless, many foundations will indemnify their directors or carry directors and officers liability insurance. A director should be aware of the scope of any indemnification or insurance and understand its limitations. **It is wise for directors asked to serve to understand the scope of the protections before agreeing to serve**. Often indemnification is provided in the bylaws or by special resolution. Insurance may not be necessary if there is a broad indemnification provision backed by a credit worthy foundation, but many foundations will obtain insurance to provide additional protection. Sample indemnification clauses can be provided upon request.

Legal Overview of the Regulation of Foundations

In 1969, Congress, reacting to perceived abuses by private foundations, created a legislative and regulatory overlay for private foundations that is complex and pervasive.[2]

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[1] *In re Walt Disney Co, Derivative Litig.,* 907 A.2d 693,749 (Del. Ch. 2005) (quoting *Graham v. Allis-Chalmers Mfg. Co.,* 188 A.2d 125, 130 (Del. 1963) and *Brehm v. Eisner,* 746 A.2d 244, 259 (Del. 2000)), aff'd, 906 A.2d 27, 55 (Del. 2006).

[2] For a historical perspective see *The 1969 Private Foundation Law: Historical Perspective on its Origins and Underpinnings*, (Thomas A. Troyer)

Since then, heightened Congressional or regulatory scrutiny of the not-for-profit sector has occurred from time to time triggered by perceived abuses or special cases that attract media attention. From 2005-2007, for example, not-for-profit organizations came under considerable scrutiny by the Senate Finance Committee, various States' Attorneys General, and the media because of alleged abuses detailed in the media. At the request of the Senate Finance Committee, Independent Sector, a membership organization, convened a panel of experts to address the perceived abuses. The Panel issued two reports and a list of thirty-three principles for good governance and ethical practices that it encourages all nonprofits to follow.

In general, the law divides charitable organizations into private foundations and public charities and imposes additional requirements and burdens on private foundations. A charitable organization is presumed to be a private foundation unless it can demonstrate otherwise.

Among the existing rules most relevant to the activities of private foundations are the following:

- The establishment of a class of persons known as "disqualified persons" of which directors, among others, are a part;

- Rules restricting or prohibiting certain conduct or activities by the foundation or its disqualified persons. This includes (i) lobbying (except in self-defense), (ii) self-dealing as defined in the Internal Revenue Code, (iii) participation in political campaigns, (iv) certain types of investments that would constitute jeopardizing investments, and (v) owning controlling interests in companies engaged in business not related to charitable activities. These topics and others are described more generally in "Selected Topics", which begins on the next page;

- The imposition of taxes on investment income, self-dealing transactions, failure to distribute income, certain activity or certain gains; and

- A requirement that private foundations distribute as charitable distributions a minimum of five percent (5%) of their qualifying assets each year.

Sanctions for failure to comply with private foundation rules potentially include a tax on both the foundation **and its disqualified persons**, possible loss of tax exemption, and repayment of all tax benefits accrued.

The following pages contain a more detailed description of the special rules applicable to private foundations.

Selected Topics

Lobbying

A private foundation may not lobby except in self-defense.

Public charities may use a portion of their funds to lobby. A private foundation can make grants to public charities that lobby, *provided* certain rules are met. Simply put, with respect to both general operating support grants and project grants, foundation grant funds cannot be earmarked for lobbying purposes. For project grants, the foundation must also show that the amount of its grant is less than the non-lobbying expenditures of the grantee in connection with the project.

There are exceptions to the definition of lobbying that permit a private foundation to fund or participate in certain activities. In shorthand, these exceptions are as follows:

- Supporting or participating in non-partisan analysis, study or research;
- Providing support for or directly providing technical analysis to legislators at the written invitation of the legislative body; and
- Examinations of or communications regarding broad social, economic and similar problems.

Private Inurement and Private Benefit

Private inurement refers to the prohibition in the Internal Revenue Code against any part of the net earnings of a § 501(c)(3) organization from inuring to the benefit of any private shareholder or individual. The private inurement doctrine forbids ways of causing the income or assets of a tax-exempt organization from flowing away from the organization to a person who has a significant relationship with the organization and is considered an "insider".

Forms of prohibited private inurement include unreasonable compensation, unreasonable rental arrangements, unreasonable borrowing arrangements, unreasonable sales arrangements and some involvement by tax-exempt organizations in joint ventures or partnerships.

In many respects, the self-dealing rules, described below, directly applicable to private foundations are a codification of the important parts of the private inurement doctrine.

Private benefit is similar in concept to private inurement and prohibits a private foundation from permitting an outsider from benefiting from a transaction in a manner that is more than incidental to the primary charitable purpose of the transaction.

A violation of the private inurement doctrine has serious consequences in that it can lead to the revocation of the tax-exemption of an organization. The private inurement rules

tolerate less benefit to insiders as incidental to a charitable purpose than would be permissible under the private benefit test for transactions with outsiders.

The prohibition against private inurement does not extend to the payment of reasonable compensation or the provision of reasonable benefits to staff. For the foundation's purposes, any time an "insider" is receiving a benefit we look carefully at the circumstances to be sure we do not run afoul of the private inurement or self-dealing rules and that there is a sound and proper justification for the case.

Self-Dealing

One critical part of the Congressional effort to curb perceived abuses by foundations in the 1969 legislation was prohibiting a foundation from having any financial transactions, direct or indirect, with "Disqualified Persons" except in very limited circumstances. "Disqualified Persons" include persons who create, fund, or control the foundation, **directors** and officers, and likely other senior executives and **their respective spouses and immediate families**. It also includes government officials above a certain pay grade.

This prohibition applies even if the foundation benefits from the transaction. An extreme example, often cited, is that a foundation cannot buy for $1 an asset owned by a Disqualified Person that is worth $1 million.

The rules can be complicated and it is in this area that a foundation can unwittingly violate the rule. Penalties can be imposed on both the Disqualified Persons AND the foundation managers who approved the transaction.

The basic prohibited transactions are as follows:

- Sale, exchange or leasing of property between a private foundation and a Disqualified Person;
- Lending of money or other extension of credit between a private foundation and a Disqualified Person;
- Furnishing of goods, services or facilities by a private foundation to a Disqualified Person and vice versa;
- Payment of compensation/reimbursement of expenses by a private foundation to a Disqualified Person;
- Transfer to or use by or for the benefit of a Disqualified Person of any income or assets belonging to a private foundation; and
- Agreement by a private foundation to pay a government official.

Reasonable Compensation

One of the most important exceptions to the self-dealing rules is that a private foundation may pay reasonable compensation for personal services "which are reasonable and necessary to carrying out the exempt purposes of the organization." The rules regarding reasonable compensation are not precise and it is important that there be an adequate basis and record to support compensation decisions especially for the more highly compensated individuals at a foundation.

The intermediate sanctions legislation directed at public charities provides some guidance that is helpful for private foundations. That includes a presumption that compensation decided by disinterested members of the Board, such as a compensation committee, based on suitable comparability data is reasonable and documented contemporaneously. If such procedures are followed, the burden falls on the IRS to demonstrate that the compensation is excessive.

Compensation paid to officers of not-for-profits is also a public relations' issue that carries with it its own set of issues. Besides potential bad publicity, compensation viewed as excessive by members of Congress could trigger public hearings and, possibly, adverse legislation.

Participation in Political Campaigns

The IRS and the Treasury Regulations prohibit a private foundation (or other § 501(c)(3) organization) from participating in political campaigns. This is an area in which the IRS has been fairly active, spurred in part by complaints from organizations alleging that churches and other religious institutions and groups have been too active. Failure to comply with this prohibition subjects the offending organization to possible loss of its tax status, a step the IRS has taken in the last few years in especially egregious circumstances.

A foundation can fund voter registration drives if very specific rules are met. Consequently, when a grant is proposed in this area, counsel takes a close look at the proposal to be sure that it fits within the appropriate criteria.

Jeopardizing Investments

A private foundation is prohibited under IRS regulations from making an investment that jeopardizes the carrying out of a foundation's exempt purpose. Under IRS regulations, an investment is considered to jeopardize the carrying out of the exempt purpose if it is determined that the foundation managers, in making the investment, failed to exercise ordinary business care and prudence in providing for the long and short-term financial needs of the foundation under the facts and circumstances prevailing at the time the investment was made.

This determination is made on an investment-by-investment basis, in each case taking into account the foundation portfolio as a whole. Certain investments will be closely scrutinized such as trading securities on margin, trading commodity futures, investments in working interests in oil and gas wells, the purchase of puts and calls and straddles, the purchase of warrants and selling short. These will be viewed, however, in the context of the overall portfolio.

Generally speaking, the nature of a foundation’s investment portfolio will help provide protection against jeopardizing investments if it is significant enough and diversified. Many foundations’ investment approaches today also include complex derivatives and other instruments to hedge positions or increase exposures which under the jeopardizing

investment rules will merit additional scrutiny. Consideration should be given to obtaining legal opinions when warranted for particularly complex or sophisticated transactions..

There are also State statutes applicable to a foundation's management of its assets. Most states now have enacted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") and there may be other relevant statue trust or other statutes that should be considered. In Illinois, for example, the Illinois Trust and Trustees Act specifies that the trustees must invest and manage trust assets as a prudent investor would, considering the purposes, terms, distribution requirements, and other circumstances. This standard requires the exercise of reasonable care, skill and caution and in the context of the trust portfolio as a whole.

UPMIFA revises the prudence standard that applies to the management and investment of charitable funds by effectively merging the laws applicable to private trusts and business corporations. It provides that, in addition to complying with the duty of loyalty imposed by general corporate law, **each person responsible for managing and investing assets of a charitable institution shall manage and invest such assets in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances**.

This standard is consistent with the business judgment rule under corporate law, as applied to charitable institutions. UPMIFA sets forth a number of factors that managers should consider, if relevant, in acting pursuant to the prudence standard:

(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 institution;
(e) The expected total return from income and the appreciation of investments;
(f) Other resources of the institution;
(g) The needs of the institution 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.

UPMIFA also incorporates a duty to diversify investments absent a conclusion that special circumstances make a decision not to diversify reasonable. It also provides that an institution should only incur costs that are "appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution".

Illinois' version of UPMIFA also affirms the power of a charitable institution to delegate to an external agent the management and investment of the institution's funds to the extent that it acts with the care that an ordinarily prudent person in a like position would use in

selecting the agent's actions. If it acts in this manner, it will not be liable for the decisions or actions of the agent. UPMIFA clarifies previous law in this regard.

Unrelated Business Activity / Excess Business Holdings

A private foundation is prohibited from engaging in activity that is not related to its exempt purposes in any substantial way. Excess business holdings also restrict a foundation from holding controlling equity interests in most types of entities. To determine whether the private foundation has an excess business holding, the ownership interest of the foundation and all Disqualified Persons (i.e., directors and members of their immediate family) are added together.

Significant penalties can attach to such activity. Certain income generated from various types of activity or investments, known as unrelated business taxable income, is not prohibited but is taxed at the normal corporate rates.

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

MacArthur Foundation
https://www.macfound.org/about/our-policies/conflict-interest-policy

Conflicts of Interest

Preamble

The directors, investment committee members, and staff of the MacArthur Foundation aspire to the highest level of ethical conduct in our work. The Foundation also values the knowledge gained from such individuals' involvement with other organizations. Inevitably, from time to time, such affiliations may create or appear to create conflicts with the individual's duty to the Foundation. To ensure that the Foundation's decisions are free of any conflicts or other inappropriate influences, the board has adopted the following policy concerning conflicts of interest and gifts.

In carrying out this policy, the Foundation relies on the good judgment and integrity of its directors, investment committee members, and staff. The Foundation encourages a culture of transparency in which such individuals fully and promptly disclose all affiliations, interests, and gifts of which they are aware that might present a conflict relating to a potential transaction, or might otherwise affect their objectivity. We ask that directors bring to the attention of their colleagues, and staff members to their supervisors' attention, all personal and professional interests or affiliations that might conflict with their duty to the Foundation. In situations where conflicts are uncertain, the Foundation encourages individuals to err on the side of disclosure.

Part I - Conflicts of Interest

Application

This Policy is intended to cover any proposed grant, investment or other Foundation business transaction in which there is a conflict of interest. A conflict of interest will be present if an individual knows that he/she or a related party has a material affiliation with or a material financial interest in the entity or with the individual involved in the transaction, or will otherwise benefit financially or derive a significant personal benefit as a result of the transaction.

The Foundation will not proceed with the following transactions in which a conflict of interest is present:

A grant to or for the benefit of an entity in which a director, staff or an investment committee member is the principal executive officer and the grant is material to the entity.

An investment or other transaction that will give rise to payment of fees, income, or profits to a director, staff or an investment committee member, or an entity in which any such individual has a material financial interest. This provision does not prevent an investment by the Foundation in an entity in which a director, staff or an investment committee member is also an investor if the investment committee concludes after disclosure of relevant facts that such investment by the Foundation is in the best interests of the Foundation.

In all other transactions involving a conflict of interest, a disinterested decision-maker (the board, the investment committee, or the president, as the case may be) will determine whether proceeding with the transaction is in the best interests of the Foundation after considering all the facts and circumstances.

Disclosure

Directors, members of the investment committee, and staff members will sign a disclosure form annually to:

Acknowledge that they have read this policy; and

Disclose the names of any organization of which they or a related party have or have had during the preceding three years a material affiliation or a material financial interest.

Such individuals will update the form whenever they acquire new affiliations or make changes to existing affiliations. Individuals are not required to make inquiries regarding affiliations or interests of any person who is not a household member.

In addition, individuals who have knowledge of any conflict of interest that has not previously been disclosed will notify the general counsel who will, in turn, inform the president or the chair of the board, as the case may be, so that appropriate action can be taken.

Directors and investment committee members do not need to disclose the identity of clients to whom they provide professional services directly or through a firm or partnership unless they conclude that the services to the client constitute a material portion of the revenues of such professional services firm and disclosure would not violate any confidentiality obligations owing to such client.

Prior to any meeting or time in which a decision will be made on a grant or business transaction, the general counsel will provide a report indicating the existence of any conflicts of interest together with any facts or circumstances he/she deems relevant for consideration by the decision-maker.

Participation in Process

Directors, investment committee members, and staff who have a conflict of interest regarding a proposed grant or transaction should not vote on or approve the grant or transaction. In addition, a staff member should not work on the grant or transaction where the conflict is present and, unless asked by another director or the president, a director, an investment committee member or a staff member should not participate in formal or informal discussions of such grant or transaction.

The chair of the board or the chair of the investment committee, as the case may be, in consultation with the president and the general counsel, will determine whether a director or staff member with a material affiliation should also be excused from the meeting when the matter is being discussed.

The prohibition against participation in the grant process does not apply when an individual is affiliated with a grantee at the written request of the Foundation. Any such request must be made by the president in the case of a staff member and approved by the chair of the board in the case of the president.

Record and Reporting

The Foundation will maintain a record of actions taken when there is a conflict of interest present with respect to any grant or transaction.

The general counsel will provide an annual report to the audit committee reflecting all transactions in which there was a conflict of interest and the actions taken.

Part II - Limitation on Acceptance of Gifts

General Rule Against Accepting Gifts

The Foundation discourages acceptance of gifts by directors, staff and investment committee members or a related party to avoid a perception that Foundation business decisions could be influenced by such gifts. Gifts include anything of value, including, meals, loans, tickets for events, or other entertainment and payments to or for the benefit of a director, investment committee member or staff.

In limited circumstances, a reasonable gift may be accepted. In considering whether to accept a gift, directors, investment committee members and staff should consult the guidance memorandum prepared by the general counsel related to this policy.

The Foundation may require that any employment-related gift be returned.

Gift Registry

Unless excused below, all gifts in excess of $100 received as a representative of the Foundation should be reported to the general counsel who will keep a registry reflecting the nature of the gift and the approximate value and report annually to the audit committee on the registry.

Gifts required to be registered should generally be applied to the overall benefit of the Foundation to the extent practical. The following do not have to be reported:

Gifts valued at less than $150 that are received as part of a broad-based promotion on the part of the donor and are made to similarly-situated persons at other organizations;

Reasonable meals provided by existing or prospective investment managers in connection with the due diligence trips of members of the investment department; and

Meals or other modest entertainment received while attending charity events.

Part III - Definitions

General Rule Against Accepting Gifts

The words underlined in this policy have the following meanings:

A related party is a member of your immediate family (children, grandchildren, parents, siblings and spouses thereof, your spouse or significant other) and includes a household member. A household member means a person residing in your household.

An entity includes a corporation, partnership, limited liability company, trust, organization, coalition, commission, university or institute (including a school, department, center, committee, or research project within a university or institute).

The principal executive officer includes the executive head or co-head of an entity, including the principal investigator of a research project or the co-chair of a commission or other entity.

A material affiliation with an entity or individual exists when a director, staff, an investment committee member, or a related party has any of the following types of relationships with the entity or individual:

Is a board member, officer, or employee of the entity;

Is the owner of more than five percent (5%) of the ownership interest of the entity;

Is a lender to the entity;

Is a landlord to or tenant of the entity;

Has an ongoing contractual relationship to provide goods or services that is significant to the Foundation representative, a related party, or the entity or the individual to whom the goods or services are being provided;

or Is a blood relative of the individual.

A material financial interest with an entity exists when a Foundation director, staff, an investment committee member or a related party:

Holds an ownership interest in excess of five percent (5%) of the total equity interest in such entity; or

Is a consultant or service provider to the entity and is paid an amount that exceeds five percent (5%) of his/her overall income or the overall income of a related party to such individual; or

Is a lender to the entity and such loans are more than five percent (5%) of the indebtedness of such entity.

A grant is material to an entity when the amount of the grant is in excess of five percent (5%) of the revenue of the entity.

Whether a director, staff, an investment committee member or a related party derives a "significant personal benefit" or has a "relationship to provide goods or services that is significant" will depend on the facts and circumstances of each case, including an assessment of whether an objective person would consider the benefit capable of affecting the individual's objectivity or independence.

Part IV - Interpretation

In interpreting all aspects of this policy, the Foundation will rely on a rule of reason guided by the policy and its underlying principles. Questions about the application and interpretation of this policy should be directed to the general counsel who is charged with making a determination whether a conflict of interest exists and recommending action to the president and/or chair of the board if the matter involves the president. If the matter involves the president, the general counsel will recommend action to the chair of the board; if the matter involves the general counsel, the president will make the determination in consultation with the chair.

ROBERT WOOD JOHNSON FOUNDATION
Conflict of Interest Policy

(Adopted by the Board of Trustees on January 21, 2004, and Amended on October 29, 2019)

Robert Wood Johnson II established this Foundation exclusively to advance charitable purposes for the public good. The Board of Trustees honors General Johnson's values by setting the highest ethical standards for the Foundation's Trustees, non-Trustee advisors to the Board and its committees, and staff. We do this in many ways, including by using the Foundation's assets prudently and efficiently, by taking measures to assure that decisions are made with integrity and in compliance with law, and by adhering to our Guiding Principles and other policies, including this Conflict of Interest Policy.

This policy is intended to provide guidance on how to deal appropriately with situations that involve conflicts of interest; moreover, we recognize that the appearance of a conflict can be as damaging as the existence of an actual conflict. Accordingly, the purpose of this policy is to avoid both the reality and the perception that Trustees, non-Trustee advisors, or staff have exercised improper influence on a Foundation decision, and it should be interpreted and applied to achieve this purpose.

This policy supplements but does not replace applicable laws governing conflicts of interest or other provisions imposing fiduciary duties on Trustees, non-Trustee advisors, and staff, such as the duty of loyalty to the Foundation when conducting Foundation business.[1]

1. Policy.

   Any actual, potential, or perceived conflicts of interest must be disclosed fully before a decision is made on the matter involved, and no Trustee, non-Trustee advisor to the Board or its committees (each, an "advisor"), or staff member may participate

[1] Note: The payment of reasonable compensation and the payment or reimbursement of expenses to Trustees, non-Trustee advisors, and staff for personal services that are reasonable and necessary to the carrying out of the Foundation's activities are not prohibited.

(other than by providing information) in any decision in which he or she has a Conflict of Interest, whether actual, potential, or perceived.

2. Definitions.
   a. Affiliation – means a relationship between (i) a Foundation Party or Immediate Family Member of a Foundation Party and (ii) a Third Party that reasonably could be expected to influence the Foundation Party's decision regarding a Transaction. Affiliation includes, but is not limited to, serving as a governing or advisory board member, officer, employee of, or paid consultant to, or having a compensation arrangement with, a Third Party.
   b. Conflict of Interest – A Conflict of Interest includes actual, perceived, and potential conflicts of interest.
      i. Actual Conflict of Interest – means a Transaction in which a Foundation Party who is in a position to make or influence the Foundation's decision regarding the Transaction has an Affiliation with a Third Party to the Transaction.
      ii. Perceived Conflict of Interest – means a Transaction in which a Foundation Party could reasonably be viewed as having a divided loyalty with respect to the Transaction.
      iii. Potential Conflict of Interest – means a Transaction in which a Conflict of Interest is likely to arise because a Foundation Party has an Affiliation with a Third Party to the Transaction.
   c. Covered Person – means the Foundation's Trustees, officers (as defined in the Foundation's bylaws), and substantial contributors (Robert Wood Johnson II); Immediate Family Members of the foregoing; and any entity in which Covered Persons (individually or collectively) own a 35 percent or greater ownership interest.
   d. Foundation Party – means a Covered Person or Foundation advisor or staff member.
   e. Immediate Family Member – means an individual's spouse or domestic partner, ancestors, siblings, children, grandchildren, great-grandchildren, and the spouses or domestic partners of the individual's siblings, children, grandchildren, and great-grandchildren.
   f. Third Party – means a person or entity involved in a Transaction or potential Transaction with the Foundation.
   g. Transaction – means any contract, grant, investment, or other arrangement related to the provision of funds, goods, or services to or from the Foundation.

3. Disclosures.
   a. Annual Conflict of Interest Questionnaire – Each Foundation Party shall complete an annual Conflict of Interest questionnaire disclosing Affiliations and any other relationship or commitment that creates or could create a Conflict of Interest. The questionnaire should be updated by the Foundation Party during the year, where warranted. Doubts about whether disclosure is warranted should be resolved in favor of disclosure.
   b. Additional Disclosure – In addition to completing the annual Conflict of Interest questionnaire, disclosure should be made, orally or in writing, any time consideration is being given to a Transaction involving a Conflict of Interest. Doubts about whether disclosure is warranted should be resolved in favor of disclosure. Trustees and advisors should disclose in writing to the Chair of the Board and president and chief executive officer (CEO). Staff members should disclose in writing to the general counsel and to the chief of staff or executive vice president.

4. Procedures for Transactions.
   a. Assessment of Matters Where There Is an Affiliation – If the Foundation considers entering into a Transaction with a Third Party with which a Foundation Party has an Affiliation, such Transaction will be assessed by the same substantive standards as other Transactions, including assessing whether the Transaction will comply with the law and be in the best interests of the Foundation. The Foundation will maintain a record of its deliberations, including any data considered in assessing the reasonableness of the Transaction.
   b. Abstention From Discussion, Decision-Making, and Evaluation
      i. Discussion – Whenever a Foundation Party has a Conflict of Interest with respect to a Transaction, the Foundation Party shall refrain from engaging in discussion (other than providing information as set forth below), or using personal influence, regarding the potential Transaction or the Third Party to the Transaction, with other Foundation Parties.
      ii. Deliberation and Voting – In all situations calling for disclosure of Affiliations, the Foundation Party should abstain from deliberating, voting, or otherwise participating in the decision other than by providing any information requested by the disinterested decision-makers. The abstention should be formally noted in the minutes in the case of a member of the Board of Trustees or advisor, and in any written record of the decision in the case of staff.
      iii. Post-Transaction Activities – If the Foundation enters into the Transaction, the Foundation Party with the Affiliation shall not participate in any

subsequent action, discussion, or evaluation in connection with the Transaction.

c. Matching Gift Program Exception – The Foundation's Matching Gift Program allows Trustees, advisors, and staff to request that the Foundation match personal contributions to eligible charities. Because the purpose of the Matching Gift Program is to encourage participants to engage in charitable activities outside of the Foundation, Trustees, advisors, and staff are not precluded from requesting matching gifts to charitable organizations with which they have an Affiliation provided they satisfy all provisions of the Matching Gift Program policy, including its disclosure requirements. Final decisions about whether to make a matching gift are reserved to the Foundation.

5. Additional Procedures Applicable to Trustees and Other Covered Persons.

   a. Trustee Communications About Proposed or Potential Transactions – Any communication by a Trustee regarding a proposed or potential Transaction with a Third Party with which the Trustee has an Affiliation initially should be directed only to the chief of staff or the executive vice president.

   b. Grants to an Organization that Employs a Covered Person – While grants to organizations that employ a Covered Person are not prohibited, the following provisions must be satisfied:

      i. The grant shall not include funds designated or used to pay the compensation or benefits of the Covered Person.

      ii. The grant cannot constitute more than 10 percent (10%) of the organization/ department's revenue for that fiscal year.

      iii. The grant shall not be for a project for which a Covered Person carries immediate oversight responsibility. (Examples of "immediate oversight responsibility" include: being the principal investigator; having responsibility for the grant budget, hiring under the grant, and/or the deliverables; or having direct supervision of the principal investigator in an organization of fewer than 500 people.)

6. Enforcement.

   It is the responsibility of the president and CEO to enforce this policy.

Distributed Annually

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.

What Foundations Need to Know About Compensation and Employment Taxes

James K. Hasson, Jr., Hasson Law Group LLP
James Wynn, Quatt Associations, Inc.
September 13, 2024

Agenda

1. Legal Framework for Foundation Compensation
2. Proactive Compensation Management – Tips and Traps
3. Q&A

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

Legal Framework for Foundation Compensation and Employment Taxes

Recipients of Compensation/Reimbursement

- Board Member
- Officer
- Other Employee or Assistant
- Lawyer, Accountant, Investment Advisor or Other Consultant
- Intern
- Combined Roles

Constraints on Compensation and Expense Reimbursements

A. Section 501(c)(3): No "Inurement" or "Private Benefit"

B. Section 4941: No Self-Dealing for Disqualified Persons

C. Section 4945: No Taxable Expenditures

D. Section 507: Private Foundation Termination

E. Section 4960: No Excess Benefits

Constraints on Compensation and Expense Reimbursements

A. Section 501(c)(3): No "Inurement" or "Private Benefit"

1. **Limitation**:

   a. Statutory: "No part of the earning . . . inures to the benefit of any shareholder or individual . . .

   b. Regulatory: "Private shareholder or individual" means a person "having a personal and private interest in" "the organization's "activities." Regulations section 1. 501 (a)- 1(c).

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Constraints on Compensation and Expense Reimbursements (CONTINUED)

2. **Enforcement**: Loss of foundation's tax-exempt status.

3. **Reporting**: Form 990-PF requires disclosure of all compensation, benefits, and expense account allowances for all directors, trustees, officers, and foundation managers as well as the 5 highest paid independent contractors. This information can be used by the Internal Revenue Service to identify payments that should be questioned.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

B. Section 4941: No Self-Dealing for Disqualified Persons

1. **Limitation**: The basic prohibition is on the payment by a foundation to a disqualified person of any amount, unless an exception applies. A key exception is for the payment of compensation for certain personal services so long as the payment is "not excessive." The limitation applies to an individual or an entity. Services of a personal nature by all of the recipients listed above should be permissibly compensated, but with questions where non-managerial employees and interns are concerned.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

2. **Enforcement**: Imposition of penalty or excise tax on disqualified person and foundation manager.

    a. Self-dealer: 10% of amount involved per year until corrected; 200% of amount involved if not corrected.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

b. Foundation manager: 5% of amount involved; joint and several liability, subject to maximum of $20,000 for each of initial and supplemental penalties. In addition, 50% of amount involved if not corrected.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

3. **Reporting**: Form 990-PF, Part VI-B, asks specifically if any payment was made to a disqualified person, with Form 4720 required to be filed and taxes paid unless an exception to self-dealing applies. The recipient disqualified person subject to tax must file a Form 4720 separately from the foundation. The Form 4720 is due when the Form 990- PF is due, without extensions, and the tax due is required to be paid at that time.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

4. **Standard for valuation**:

   a. The Regulations under section 4941 cross-reference the standards of Regulations section 1.162-7, dealing with "ordinary and necessary" expenses for business expense deduction purposes. Numerous judicial decisions have undertaken to apply these standards in a business context, with not all of the standards making sense in the case of a charitable organization.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

b. For example, in L&B Pipe and Supply Co. v. Commissioner, 67 T.C.M. 2798 (1994), the United States Tax Court, applying the law of the Ninth Circuit Court of Appeals, identified five relevant factors: (1) roles of the compensated individual in the employer's workforce, including the employee's qualifications, hours worked, duties performed and employee's general importance to the employer's success;

Constraints on Compensation and Expense Reimbursements (CONTINUED)

(2) external comparison, considering amounts paid by similar companies for similar services; (3) character and condition of the employer, including size by sales, net income, or capital value, the complexities of the business, and general economic conditions; (4) conflict of interest, meaning an opportunity to disguise nondeductible dividends as deductible compensation; and

Constraints on Compensation and Expense Reimbursements (CONTINUED)

(5) internal consistency, meaning adherence to a formal or at least identifiable and consistently applied compensation program. The court concluded that superior results readily justified well above-average compensation.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

C. Section 4945: No Taxable Expenditures

1. **Limitation**: The statute provides that a payment for a non-charitable purpose will be a taxable expenditure, and section 53.4945-6(b)(2) of the Regulations provides that "any expenditure for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures . . . ."

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Constraints on Compensation and Expense Reimbursements (CONTINUED)

2. **Enforcement**: Imposition of penalty or excise tax on foundation and foundation manager.
    a. Foundation: 20% of expenditure; 100% of amount involved if not corrected.
    b. Manager: 5% of the expenditure; 50% of the expenditure if not corrected. Joint and several liability, subject to a maximum of $10,000 initial tax and $20,000 for supplemental penalty.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

3. **Reporting**: Form 990-PF, Part VI-B, question 5a(5), requires identifying any non-charitable expenditure, which an excessive compensation payment would be unless an exception applies. Form 4720 must be filed to report a taxable expenditure by the due date referenced above, and to pay the tax due.
4. **Relationship to Section 4941**: Most excessive compensation taxable under Section 4941 will also be a taxable expenditure under Section 4945, resulting in penalty taxes being imposed on both the disqualified person recipient and the private foundation payor. See, *e.g.*, Kermit Fisher Foundation v. Commissioner, T.C. Memo 1990-300, 59 T.C.M. 898 (6/18/1990).

Constraints on Compensation and Expense Reimbursements (CONTINUED)

D. Section 507: Private Foundation Termination.

1. The IRS is authorized to terminate a private foundation for willfully repeated acts or a single willful and flagrant act that gives rise to a private foundation penalty tax, including for self-dealing or a taxable expenditure.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

E. Section 4960: No Excess Benefits

1. **Limitation**: An excess benefit is either:

a. Compensation greater than $1 million/year paid by a foundation to a covered employee; or

b. "Excess parachute payment" by a foundation to a covered employee, which means any payment upon separation from service that equals or exceeds 3 times the base amount. "Base amount" means, by reference to the standards of Section 280G(b)(3), an individual's average annual includible compensation for the "base period," which is defined as the most recent 5 years ending before the date for determining the payments.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

2. **Applicable employer**: Any section 501(a) organization, among others, so private foundations are included.
3. **Covered employee**: Any one of the 5 highest compensated employees for the year or a prior year (after 2016), except for a medical professional compensated for performing medical services.
4. **Compensation**: Any remuneration in the form of wages paid by a foundation or related organization to a covered employee, other than a Roth contribution, but to include any section 457(f) ineligible deferred compensation plan amounts.

Constraints on Compensation and Expense Reimbursements (CONTINUED)

5. **Penalty**: Employer pays ordinary income tax on excess compensation.

6. **Reporting**: Form 990-PF, Part VI, question 8 requires identifying any payment of excess compensation or an excess parachute payment as defined in Section 4960. Form 4720 is required by Regulations sections 53.6011-1(b) and 53.6071-1(i). Due by the 15th day of the 5th month after the end of the foundation's taxable year.

Constraints on Use of Foundation Assets

A. **Office Space, Equipment and Supplies**: IRS has ruled, for example, that the use of foundation's paintings in the residence of a substantial contributor constituted self-dealing. Rev. Rul. 74-600, 1974-2 C.B. 385.

B. **Grant Attribution**: Mere acknowledgement by a foundation of a donor's contribution is generally not considered by the IRS to be a use of one of the foundation's assets.

Constraints on Use of Foundation Assets

C. **Expense Sharing**: Payment to a third party of a proportionate share of expenses incurred by both a private foundation and a disqualified person for similar property management will generally not be self-dealing or a taxable expenditure. See, *e.g.,* Private Letter Ruling 201415010 (1/16/2014). But a foundation cannot make payment to a disqualified person of its share of such expenses for re-transmission to the service provider.

D. **Co-Investing**: Simultaneous investment by a foundation and a disqualified person in the same business corporation or partnership was initially sanctioned by the IRS years ago but is being reconsidered. See, *e.g.,* Private Letter Ruling 201447043 (8/27/2014).

Employment Taxes (Federal)

A. **Liability**: Each employer is obligated, under threat of penalty taxes, to make withholding tax and employee Social Security tax payments to IRS. Internal Revenue Code section 3509 (a).
   1. "Employer" is defined for withholding purposes as a person for whom an individual performs services "as the employee of such person…."

B. **Registration and Reporting**: Each employer must obtain Form I-9 Employment Eligibility Verification from each employee and retain the Form I-9 in the employer's records. Tax-exempt charitable organizations are exempt from the requirement to file a Form 940 Federal Unemployment Tax Return, but must file a Form 941 Quarterly Federal Tax Return for FICA taxes on a quarterly basis (unless the organization is so small that an annually-filed Form 944 can be filed instead, unlikely for any foundation).

Employment Taxes (Federal)

C. **Tax Payment**. Electronic funds transfer (EFT) is required for all federal tax deposits, generally by 8 P.M. Eastern Time the day before the payment is due. Generally, quarterly payments are due on April 30, July 31, October 31 and January 31, but deposits must be made in advance on a monthly or semiweekly schedule, depending on payroll size (except for employers with very small quarterly tax amounts).

D. **Information Delivery**: Form W-2 is to be furnished to each employee by January 31 of the following calendar year for payment of compensation, followed by filing Form W-3 with Social Security Administration by February 28.

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Proactive Compensation Management – Tips and Traps

Proactive Compensation Management

Tips and potential traps by Foundation role:

- New or incumbent executives
- Outgoing/retiring executives
- Board Members/Trustees

New or Incumbent Executives

Four steps to proactively support or establish reasonable but competitive compensation:

1. Determine the reasonable range of market compensation
2. Develop or confirm compensation philosophy/strategy
3. Pay within the market range based on specified principles
4. Document decisions and rationale

New or Incumbent Executives

#1 - Determine the reasonable range of market compensation:

a) Identify reliable and relevant compensation data

b) Specific peer foundations vs. survey data (COF, etc.)

c) Asset size as a proxy for scope of management responsibility

New or Incumbent Executives

1 - Determine the reasonable range of market compensation (continued):

d) Other considerations when identifying comparables:

- Grantmaking areas
- Type of grantmaking – complexity of grantmaking and monitoring (i.e., venture philanthropy)
- Impact/Geographic scope

New or Incumbent Executives

#2 - Develop or confirm compensation philosophy/strategy:

a) Specify the foundation's overall midpoint/target (median, 75th percentile, etc.)

b) Identify factors that might influence pay above or below midpoint/target (tenure, performance, etc.)

c) Agree how pay may evolve annually – manage expectations

New or Incumbent Executives

3 - Set pay within the market based on specific principles:

Should other components of compensation be incorporated?

1. Annual bonus
2. Retention/deferred compensation – 457 Plans, Split Dollar
3. Retirement savings

#4 - Document decisions and rationale (institutional memory) – Original Donor vs. Future Trustees

Outgoing/Retiring Executives

<u>Proactive consideration and planning is essential</u>

- Engage the executive in advance on plans/timeline – retirement considerations often take several years to implement
- Document any discussions or agreements (potential traps – board turnover, differing understandings, etc.)
- Understand contractual provisions (e.g., severance)

Outgoing/Retiring Executives

Common issues/requests by outgoing executives that should be considered or managed in advance:

- Farewell Awards / “Catch-up” compensation
- Sabbatical
- Retiree Health
- Post-Termination Consulting
- Emeritus Status/End of Career Awards

Board/Trustee Compensation

- Document the rationale or need for compensating board members
- Consider pay structure – Annual Stipend, Per Meeting Fees, etc.
- Compensation for professional services by the Board member
- Family members/ conflicts of interest/third-party advisors or fiduciaries

Board/Trustee Compensation

Factors to consider in establishing amounts:

- Time commitment
- Role of board members in foundation management (e.g., trustees or trustees and grants management)
- Specific requisite professional backgrounds/experiences
- Market data – may require a different peer group or survey

Q & A

What Foundations Need to Know About Compensation and Employment Taxes

James K. Hasson, Jr., Hasson Law Group LLP
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September 13, 2024

Key Issues in Charitability

Ann K. Batlle, Morgan Lewis
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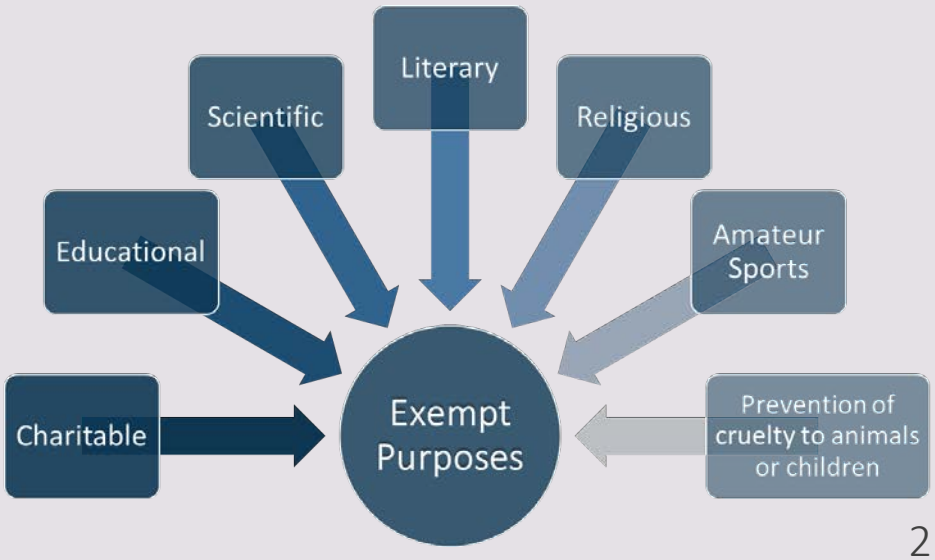
September 13, 2024

Overview

- **Back to Basics: Charitable Purposes**
- **Back to Basics: Additional Requirements**
  - Private Benefit; Illegality
- **Deeper Dive: Charitable Activities**
  - Economic Development; Environment & Climate
- **Putting it all together and making the case**

Back to Basics: Charitability



Back to Basics: Charitability

"Charitable": used in the "generally accepted legal sense" and includes:

- Relief of the Poor
- Advancement of Religion
- Advancement of Education/Science
- Erection and Maintenance of Public Buildings, Monuments or Works
- Lessening the Burdens of Government
- Promotion of Social Welfare by:
  - Lessening neighborhood tensions,
  - Eliminating prejudice and discrimination,
  - Defending human and civil rights secured by law, and
  - Combating community deterioration and juvenile delinquency

Treas. Reg. §1.501(c)(3)-1(d)(2)

Back to Basics: Additional Requirements

- Charitable organizations must be Organized and Operated Exclusively for Exempt Purposes

EXCLUSIVELY = PRIMARILY

- Cannot meet this test if more than an insubstantial part of activities does not further an exempt purpose

Back to Basics: Additional Requirements

- Commericialty = competition
- Private Benefit
- Political Activity
- Illegality / Contrary to Public Policy

Back to Basics: Private Benefit

Must be qualitatively AND quantitatively "incidental"

Qualitatively:

Private benefit is a **mere byproduct** of the public benefit

Quantitatively:

Private benefit is **insubstantial** compared to the public benefit of the activity

Back to Basics: Illegality

Trusts violating law or public policy cannot qualify for charitable status.

Restatement (Second) of Trusts § 377, comt. c. (1959)

"to qualify for exemption [under 501(c)(3)], an institution must show, first, that it falls within one of the eight categories expressly set forth in that section, and second, that its activity is not contrary to settled public policy."

Bob Jones Univ. v. United States, 461 U.S. 574 (1983)

See, generally, "Illegality and Public Policy Considerations," 1994 IRS EO CPE Text available at: https://www.irs.gov/pub/irs-tege/eotopicl94.pdf

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Back to Basics: Illegality

- Section 501(p) suspends the exemption of organizations designated or identified as a terrorist organization or that support or engage in terrorist activity
- Suspended organizations are listed on the IRS website at: https://www.irs.gov/charities-non-profits/charitable-organizations/suspensions-pursuant-to-code-section-501p
- H.R. 6408 proposes expanding 501(p) to suspend exemption of organizations providing more than a de minimis amount of "material support or resources" to a terrorist organization during a three-year look-back period.

Deeper Dive: Economic Development

The IRS has listed the following factors as necessary to conclude that an organization formed to promote economic development is primarily accomplishing charitable purposes despite the presence of a private benefit:

- Assistance is targeted to aid an economically depressed or blighted area;
- Assistance benefits a disadvantaged group, such as minorities, the unemployed or underemployed; and
- Assistance is for businesses that have actually experienced difficulty in obtaining conventional financing because of the deteriorated nature of the area in which they were or would be located, or their minority composition.

See, e.g., "Economic Development Corporations: Charity Through the Back Door," 1992 IRS EO CPE Text , available at: https://www.irs.gov/pub/irs-tege/eotopicg92

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Deeper Dive: Economic Development

Relatedly, activities of organizations with the primary purpose of *combatting community deterioration* may include:

- housing assistance;
- economic development;
- historic preservation;
- prevention of deterioration; and
- planning and enforcement.

"[t]o be charitable, the benefits of the organization's activities must **flow principally to the general public**. Any private benefit should be incidental to the exempt purposes."

(IRS Exempt Organizations Technical Guide, TG 3-3 Exempt Purpose, Charitable IRC (501)(c)(3) at p. 44; https://www.irs.gov/pub/irs-pdf/p5781.pdf)

Deeper Dive: Economic Development

Economic development can also contribute to the *relief of the poor and distressed*, including direct financial assistance or the provision of services that relieve the poverty or distress of this charitable class. There is no common definition of what it means to be "poor" or "distressed", but certain activities conducted to benefit identifiable classes of people that may qualify under this purpose, include:

- Assistance to low-income individuals:
  - Job creation, income enhancement, goods and services, affordable housing, financial inclusion
- Assisting the sick and handicapped
- Fire, rescue, and emergency services

Deeper Dive: Economic Development

Are all economic development and job creation efforts charitable?

Focus:

- What is the public benefit being accomplished through allocating charitable dollars to for-profit companies for economic development and job creation?

Focus:

- Does the ultimate good received by the general public outweigh the private benefit to the for-profit companies?

Deeper Dive: Economic Development

Key Factors:

What kind of jobs?

- For whom (sometimes, how many)?
- What about "green" jobs?

Key Factors:

- The area being served is deteriorated and in need of revitalization
- The activities are designed to attract businesses that would not, but for the assistance of charitable dollars provided, choose to locate in the area
- The businesses are providing jobs for unemployed and underemployed residents of the community
- Other indicia (e.g., promotion of health, furthering U.S. policy/programs)

Deeper Dive: Environment/Climate

IRS views on environmental protection and preservation purposes / activities have evolved over time.	Early rulings focus on other charitable rationales, e.g., education, lessening the burdens of government, and preservation of ecologically significant land.
	More recent private letter rulings demonstrate expanding view of the charitability of environmental preservation and climate change mitigation activities.
	However, not all environmental preservation and climate-related activities are deemed charitable.

Deeper Dive: Environment/Climate

- ✓ Grants to nonprofits and governments for electric busses (PLR 202034001)
  - *Analysis: Emissions reductions improve the environment and public health*
- ✓ Demonstration farm project showing how environmentally friendly, advanced agricultural methods, when applied efficiently, could increase farm productivity and produce food to feed people in an underdeveloped country (PLR 200343028)
  - *Analysis: Promotes conservation and education*
- ✓ Environmental investment fund: below market returns + specific environmental benefit objectives / investment guidelines + no significant purpose of production of income (PLR 200136026)
  - *Analysis: Contributes to conservation and economic development in environmentally sensitive areas.*

Deeper Dive: Environment/Climate

- X Providing solar panels to low and middle-income households (PLR 201210044)
  - *Analysis: Environmental benefit of activities is "indirect and tangential"*
- X Providing down payment assistance to low- and moderate-income homebuyers purchasing LEED-certified homes (PLR 201017066)
  - *Analysis: Environmental benefits are "non-specific and indirect," and the program conveys a substantial private benefit to the homeowners and developers*

Deeper Dive: Environment/Climate

- X Developing products to perform or support global cooling and carbon sequestration technologies and engage the public in using new materials and products of benefit to the climate (PLR 202228015)
  - *Analysis: Primary commercial purposes and activities outweigh environmental purposes*
- X Providing carbon-neutral certification services and referring businesses to a for-profit company to purchase carbon offsets (PLR 201221023)
  - *Analysis: Serving as an intermediary for another business does not preserve the environment and no activities actually cause a reduction in carbon emissions*

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Deeper Dive: Environment/Climate

Are all efforts to combat climate change charitable?

Focus: Demonstrate direct and/or significant environmental or other charitable benefits, and that the charitable benefits of the activities outweigh any commercial or private benefits

Key Factors

- Activities involving tangential or indirect environmental benefits and significant commercial or private benefit will generally face more scrutiny and pressure
- When in doubt, link goals to other charitable purposes

Analyzing and Making the Case

Is activity "inherently" charitable?

Does it fit within the regulatory definition of charitability?

If so, how do we best articulate the fit?

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Analyzing and Making the Case

If not, does it serve a charitable purpose?

In service of **who** (charitable class)

In service of **where** (community/location in need)

In service of **what** (changing behavior, demonstration/goal to move the market)

Analyzing and Making the Case

Document

What is the project purpose?

What metrics will we require to achieve the purpose(s)?

Consider use of covenants to strengthen charitability

THANK YOU

Key Issues in Charitability

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September 13, 2024