The Nonprofit Universe

Public Charity v. PF

Section 501(c)(3)

Public Charities
(approx. 1 million)

Private Foundations
(approx. 95,000)

Operating
Non-operating
Governance

State Law: Three Fiduciary Duties

• Duty of Care
  – Reasonable diligence - awareness and participation
• Duty of Loyalty
  – The foundation comes first
  – Avoid conflicts of interest
• Duty of Obedience
  – Honor donor intent
  – Focus on the charitable mission
  – Observe rules and policies

Practical Responsibilities
**Working Effectively**

- Understand roles and responsibilities
- Build appropriate structure for the work
- Using committees – delegate, don’t abdicate
- Focus on issues that need board input
- Make decisions
- Work as a team both within the board and with the staff

**Conflicts of Interest**

- Personal interest differs from the foundation’s
- Conflicts range from per se legal violations to ethical considerations
- Not all conflicts are prohibited; often may be managed
- Adopt and follow written conflict of interest policy
  - Disclosure
  - Abstain from voting (some leave the room)
  - Document, document, document

**Mission, Vision, Strategy**

- Mission – In what areas do you want to make a difference
  - Review of mission statement with Board and staff
  - When to modify or change
  - Honor legacy, but be intentional
- Vision – What goals to you wish to accomplish
  - What is it we wish to accomplish and by when?
  - Setting Goals
- Strategy – How will you reach your goals
  - Who should we listen to?
  - What is the process?
  - Realism and change
  - Evaluation
Governance Policies

• Should be in writing, approved by the Board, reviewed at least annually, and updated as needed
• Common Policies
  — Board membership
  — Meeting management
  — Personnel (if any)
  — Records retention
  — Investment and spending
  — Travel & expense reimbursement
  — Attending fundraisers
  — Trustee compensation
  — Whistleblower
  — Conflicts of interest

Operational Issues

Private Foundation Rules

• Excise Tax (§4940)
• Self-dealing (§4941)
• 5% Payout (§4942)
• Excess Business Holdings (§4943)
• Jeopardy Investments (§4944)
• Taxable Expenditures (§4945)
Self-Dealing

- No transactions with “disqualified persons”
  - Officers, directors, trustees
  - Substantial contributors
  - Family members of the above
  - Businesses they control
- Major Exception – Compensation
  - Reasonable
  - Furthers exempt purposes
  - Personal services (legal, accounting, banking, investing, etc.)?
- Penalties – 10% on self-dealer, 5% on managers

5% Payout

- Basic Rule
  - Each year make qualifying expenditures that equal or exceed about 5 percent of average assets
- What counts?
  - Grants
  - Program-related investments
  - Reasonable administrative expenses (except for investment management)
  - Direct charitable activities
  - Cost of assets purchased to carry on charitable activities
- Set asides

Excess Business Holdings

- Private foundation may not own a controlling interest in a for-profit company
  - Generally 20 percent
  - Add up what the foundation owns PLUS all shares owned by disqualified persons.
- 2 percent safe harbor
- 5 years to divest assets
Jeopardy Investments

- Investments that jeopardize exempt purposes
- There are no *per se* jeopardy investments
- Investments considered in context of risk/asset allocation of the entire portfolio
- Some will attract extra IRS attention
- Penalties apply managers, then foundation.

Taxable Expenditures

- Political activity
- Lobbying
- Grants to individuals for travel, study or research
- Grants to other than public charities
- Grants for purposes that are not charitable

Applying the Rules
Hiring Family Members

- Personal Services:
  - Banking, legal, accounting, investments
  - Not - interior decoration, janitorial
  - Query - real estate management
  - Narrow interpretation by IRS
- Reasonable:
  - What similar people get paid for similar work in similar circumstances
  - Generally no percentage based compensation
- Necessary: Consistent with exempt purposes

Determining Compensation

- Data – use appropriate comparable
- Decision by disinterested directors
- Document, document, document

<table>
<thead>
<tr>
<th>President, Family Foundation</th>
<th>Salary</th>
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<tbody>
<tr>
<td>Assets (millions)</td>
<td>Median</td>
</tr>
<tr>
<td>$20 to $50</td>
<td>$121,000</td>
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Travel Expenses

- Spouses and children are disqualified persons
- Paying travel expenses for them is self-dealing
- Two Exceptions:
  - Family has reasonable foundation duties, or
  - Treat as taxable income to person who is related to the reimbursed
- Expenses must be reasonable
- Note: training for future boards
Paying Pledges

- Can’t assume debt of a disqualified person
- State law determines whether a pledge is legally binding
- Be careful in communicating with potential grantees

Grants to Non-Charities

- You can make a grant to any organization—as long as it is for charitable purposes
- Safest grants are to IRS recognized charities
- Otherwise — “expenditure responsibility”
  - Pre-grant inquiry
  - Written agreement
  - Funds held separately by grantee
  - Regular reports from grantee
  - Summary status on Form 990-PF

Grants Outside the U.S.

- PF can make a grant anywhere in the world
- Three Options
  - IRS recognized Grantee
  - Expenditure Responsibility
  - Equivalency Determination
- OFAC, SDN lists and other anti-terrorism concerns

We’d like to apply for a grant!
Scholarships

- Pursue education, achieve an objective, develop a skill
- Charitable class
- Objective and non-discriminatory basis
- No disqualified persons
- IRS pre-approval required

Managing Risk

Organizational Risk

- General liability
- IP infringement
- Contract breach
- Slander / Libel
- Fraud / Fidelity
- Discrimination and Harassment
- Wage and hour
- OSHA
- Retirement (ERISA)
- Securities
- State registrations
- IRS rules
- Patriot Act / FCPA
- Child protection
- Campaign Finance
- FEC / LDA
- Etc...

"I know so much, I don't know where to begin."
**Personal Risk**

- Directors can be held personally liable for their actions as directors
- Directors can be named as defendants for actions of the foundation
- Defending a case can be expensive for both the individual and the foundation

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**Indemnification**

- Coverage depends on state law
  - Good faith
  - Best interest of the foundation
- If the standard is met, coverage is broad
- Permissive vs. mandatory
- Third party claims vs. derivative claims
- Doesn’t protect the foundation

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**Directors and Officers Insurance**

- Protects directors and the foundation
- Coverage depends on the policy
  - Breach of duty, neglect, error, misstatement, omissions, etc.
  - Attorney fees and court costs
  - Excludes bodily injury and property damage
- Usually excluded:
  - Knowing and willful violations of the law
  - Dishonesty, criminal acts, state law fines and penalties, nuclear waste, ERISA