

# Navigating Philanthropy's Legal Issues

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## Organizational Issues

- Be Familiar With Corporate Documents
  - Articles of Incorporation
  - Bylaws
  - Minutes
- Application for Tax-Exempt Status (Form 1023)
  - Make Sure Determination Letter is Current



## Information Found in Corporate Documents

- Name of Corporation
- Corporate Purposes (Fields of Interest)
- Board Number and Selection Process
  - Self-Perpetuating
  - Member Selected
  - Term Limits
- Resident Agent and Address
- Committee Structure
- Officers
- Indemnification Procedure
- Public Charity/Private Foundation Status (IRS Determination Letter)



## Board Meetings

- Quorum
- Approve Minutes
- Committee Reports (Should Board approve Grants?)
- Accurate Minutes
  - Record Dissents (By Name or Number)
  - Record Votes
  - No Unnecessary or Irrelevant Information



## Rights and Responsibilities of Board Members

- Two Duties
  - Duty of Care
  - Duty of Loyalty



## Duty of Care

- Informed, good faith decisions
- Regular attendance at board and committee meetings
- Can rely on reports and consultants, if reliable
- Delegation is permissible
- Monitor investments



## Duty of Loyalty

- Undivided Allegiance
- Disclosure of conflicts/Conflict of Interest Policy
- Intermediate Sanctions (if Public Charity)



# Operational Issues

- Conflicts of Interest
  - Private Inurement
  - Private Benefit
  - Intermediate Sanctions (If Public Charity)
    - Applies to Excess Benefit Transactions (including compensation arrangements)
    - 25% Tax on the Self-Dealer (200% if not corrected)
    - 10% Tax on the Board (up to \$20,000)
  - Conflict of Interest Policy
    - Sarbanes-Oxley
    - Best Practices
      - New York
      - California





## Private Foundation Excise Taxes

- Tax on Net Investment Income (2%/1%)
- Self Dealing
- Minimum Distributions
- Excess Business Holdings (20% less amount held by disqualified persons)
- Jeopardy Investments
- Taxable Expenditures



## Self Dealing

- Prohibits transactions between private foundations and disqualified persons (regardless of whether it's a good deal for the foundation)
- Disqualified persons include substantial contributors, directors, officers, 20% owners of substantial contributors, family members, entities controlled by substantial contributors and government officials



## Prohibited Acts

- Sales and exchanges
- Loans
- Use of foundation assets to benefit a disqualified person
- Payments of compensation are permissible if not excessive and for personal services in furtherance of exempt purposes (must be professional or management services)



## Exceptions to Self Dealing

- “Incidental and Tenuous” benefits permitted (mere recognition) – think public radio
- Public acknowledgement of contribution is OK  
Receipt of economic benefits is not
- Naming rights are fine
- Foundation grants may not satisfy pledges made by disqualified persons
- Estate exception



## More Self Dealing

- Purchase of tables – a minefield
- Not a problem if Foundation Board member is on Board of Grantee



## Minimum Distributions

- Must distribute 5% of assets (one year lag time)
- Includes grants to public charities, private operating foundations, direct expenditures for charitable purposes and administrative expenses
- Problems with illiquid assets
- What to do when the stock portfolio has tanked (use of a line of credit). Is a pledge legally binding?



# Taxable Expenditures

- No political activities or lobbying
- Grants to individuals (must have a charitable class) – must be based on objective criteria and may need to be approved in advance by IRS
- If grantee organization is not a public charity, will have to exercise “expenditure responsibility”
- Watch out for grants to Type III supporting organizations
- International grants are ok – but if charity is not a 501(c)(3) may have to exercise expenditure responsibility or perform an equivalency determination. Consider “Friends of” organizations.
- Anti-money laundering and anti-terrorist concerns



# Lobbying

- Two Types of Lobbying:
  - Direct Lobbying
  - Grassroots Lobbying





## Direct Lobbying

- Communication with a legislator, legislative staff, or other government official (state, federal or local)
- Refers to specific legislation or legislative proposal
- Takes a position



## Grassroots Lobbying

- Communication with the general public
- Refers to and takes a position on specific legislation
- Includes a “call to action”



## Exceptions to Lobbying

- Nonpartisan Analysis and Research
- Self Defense
- Technical Assistance in Response to a Written Request
- Discussion of Broad Social Issues
- General support grant by a private foundation to a public charity is ok if not earmarked to be used to influence legislation
- Foundation grant to fund a specific proposal is ok if not earmarked for lobbying and amount of grant does not exceed the non-lobbying portion of the project



## Political Activity

- Cannot participate or intervene in any political campaign on behalf of any candidate for public office (national, state or local)
- Watch out for “indirect” campaign activity (biased voter guides, issue advocacy tied to a candidate, etc.)
- Nonpartisan voter education and candidate forums may be ok



## Political Activities (cont.)

- Foundations generally prohibited from conducting or paying the expenses of conducting a voter registration drive.
- Can publish candidate responses to questionnaires and distribute candidate voting records – but can't rate.
- Candidate appearances without mention of candidacy or endorsement is permitted.
- Can be involved in issue advocacy, but not if it functions as disguised political campaign intervention
- IRS looks for indirect endorsements and politically motivated timing of events and grants.
- Avoid issue advocacy where a particular candidate is identified with the issue.



## Political Activity (even more)

- Foundation representatives can participate in the political process in their personal capacity, but need to be clear that they are not speaking in their Foundation capacity.
- Avoid wearing political buttons, etc. at a Foundation sponsored event.
- Letters to newspapers should avoid mentioning Foundation position.



# Unrelated Business Income Tax ("UBIT")

- Three elements
  - Trade or Business
  - Regularly Carried On
  - Unrelated to Exempt Purposes



## Exceptions to UBIT

- Passive Income (Rents, Royalties, Interest, Capital Gain)
- Services provided by Volunteers
- Most fundraisers





## Liability Protection

- Insurance (D&O, property, E&O)
- Corporate Protection
- Volunteer Protection Acts (State and Federal)
- Indemnification



## Alternatives to Private Foundations

- Donor Advised Funds
- Supporting Organizations
- Private Operating Foundations
- Use to create higher charitable deductions and avoid self dealing situations



## Filing and Disclosure Issues

- Form 990/990PF
- Personal Property Tax Returns
- Charitable Solicitation
- Make available 990's, 1023
- Charitable Substantiation Rules (Receipts)
  - What Portion is Deductible?

