

Top 10 Ways Family Foundations Get Into Trouble



COUNCIL *on* FOUNDATIONS

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Key Issues

- Self-Dealing
- Hiring Family Members
- Conflicts of Interest
- Travel Expenses
- Attending Fundraisers
- Paying Pledges
- Sharing Resources
- Grants to Non-Charities
 - SO Grants
- Grants Outside the US
- Grants to Individuals



"Don't get caught."



Self-Dealing

- No transactions with “disqualified persons”
 - Officers, directors, trustees
 - Substantial contributors
 - Family members of the above
 - spouse, ancestors, children, grandchildren, great grandchildren and spouses of same.
 - Businesses they control
- Penalties
 - Rectify the violation (pay it back)
 - 10% on self-dealer
 - 5 % on managers



Self-Dealing

- Prohibited Transactions
 - Sale, exchange or leasing of property between foundation and disqualified person (in either direction!)
 - Lending money
 - Furnishing goods or service
- Permissible Benefits
 - Incidental and tenuous
 - Public recognition / goodwill
- Major Exception - Compensation



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 comparables
- Decision by disinterested governing board or committee
- Document, document, document

Chief Executive Officer/President of a Family Foundation (2012)

Asset Group (in millions)	Salary		
	Median	Mean	Range
\$10 to \$24.9	\$101,363	\$103,169	\$47,000 to \$185,000



Conflicts of Interest

- Definition – any situation in which there are competing loyalties
- Some conflicts are illegal
- Others are matters of judgment and ethics
- Policies and procedures



Travel Expenses

- Spouses and children are disqualified persons
- Paying travel expenses for them is self-dealing
- Two Exceptions:
 - Family member has reasonable foundation duties
 - Treat reimbursement as taxable income to foundation director or staff person whose relative is reimbursed
- Expenses must be reasonable
- Training for future board service needs a robust program



Attending Fundraisers

- Possibly self-dealing if used by a disqualified person
- Ticket may have some economic value
- Charitable dollars can't provide private benefit
- No violation if staff has duty to monitor and evaluate
- OK if value treated as income
- No bifurcation permitted



Paying Pledges

- Assuming a debt of a disqualified person is self-dealing
- Legally binding pledges may not be paid by the foundation
- State law determines whether a pledge is legally binding
- Be careful in communicating with potential grantees



Sharing Resources



“Don’t be silly – lots of men share the same briefcase.”

- Foundation can only pay disqualified person for “personal” services
- Payments to third parties is ok
- 0% loan to foundation ok
- Records must be meticulous
- Disqualified person can usually donate resources
 - No deduction for partial interests in property
 - No deduction for services



Jeopardy Investments

- Investments judged on relationship to portfolio
- No per se bad investments
- Fiduciary responsibilities under state law
 - In good faith and with care of ordinarily prudent person
 - Costs must be reasonable
 - Reasonable effort to verify facts
- May delegate but exercise prudence in
 - Selecting manager
 - Establishing scope and terms of delegation
 - Periodically reviewing manager's actions



Due Diligence

- Investment policy
 - Asset allocation
 - Risk tolerance
 - Balancing
- Can you understand the investment strategy?
- What controls are in place?
- Social network references not enough
- Who's the auditor?



Due Diligence

- Ongoing responsibility
 - review reports
 - obtain financial statements
 - monitor portfolio
 - compare transactions



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 to Supporting Orgs.

- Type matters
 - Type I – parent-subsidiary (parent appoints majority of board)
 - Type II – brother-sister (majority of board overlaps)
 - Type III – minimal contact (some overlap + “responsiveness”)
- Qualifying distributions
 - Grants to type I and II SO’s generally count
 - Grants to type III only if “functionally integrated”
 - PF disqualified person can’t control SO or org. it supports
- Taxable expenditures
 - Expenditure responsibility for type III unless “functionally integrated”



Determining SO Status

- SO Status
 - IRS Business Master File (not IRS Publication 78)
 - Grantee's IRS determination letter
- Type
 - Written representation by grantee
 - PF collects and reviews governing documents
 - Written reps. From supported orgs. for type III
- Alternative -- Opinion of counsel



Grants Outside the U.S.

- Foundations can make grants anywhere in the world
- Three Options
 - Grantee is recognized by IRS
 - Expenditure Responsibility
 - Equivalency Determination
- Anti-terrorism concerns



Scholarships

- Pursue education, achieve an objective, develop a skill
- Charitable class
- Objective and non-discriminatory basis
- No disqualified persons
- IRS pre-approval required
- Special rules for employees or their dependents



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



Disaster Relief / Hardship

- Must benefit a charitable class
- Establish a process for determining who will receive assistance and permissible types of assistance
- Recordkeeping varies depending on type of assistance
- Tips
 - It helps to plan ahead
 - Intermediaries are often a good option





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QUESTIONS

Resources

- www.cof.org/legal

Resources from the Council on legal issues

- www.learnfoundatoinalaw.org

Collaborative project of the Packard, Gates, Hewlett and Moore Foundations including training modules on advocacy rules and expenditure responsibility rules

