Legal Session

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Agenda

• Legal context
  • Nonprofit universe
  • Public and private foundations
  • Community foundations
• Nature of component funds and asset ownership
  • Working with donors/donor control
  • Working with agencies
• Grantmaking pitfalls
• Legal aspects of finance and administration
• Cooperative relationships
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The Nonprofit Universe

Nonprofit

Tax Exempt

501(c)(3)
Public Charities and Private Foundations
§501(c)(3)

Section 501(c)(3)

Public Charity

Private Foundation

Non-Operating

Operating
Public Charities

Rick Avery

Patricia Robinson
Legal Requirements for Community Foundations

- Treas. Regs. 1.170A-9(f)(11)
- Name
- Common governing instrument
- Common governing board
- Variance power
- Reasonable return on investments
- Periodic financial reports
Nature of Component Funds:

• Why is this important?
  • Single entity vs. aggregation of separate funds
  • Require irrevocable transfers
  • Not directly or indirectly subject to material restrictions or conditions
Material Restrictions

• From Treas. Regs. 1.507-2(a)(7): Restriction or condition cannot prevent Community Foundation from freely and effectively employing assets or income in furtherance of exempt purpose.

*Ultimately a facts and circumstances test*
Donor Restrictions

• At the time the gift is made, a donor may:
  • Name the fund
  • Decide whether it is endowed or pass-through
  • Designate a charity (or charities) to be the beneficiary
  • Designate a purpose
Donor Restrictions

At the time the gift is made, a donor may not:

• **Control** selection of charities after gift has been made

• **Control** timing of distributions

• **Require** community foundation to hold certain assets

• **Mandate** irrevocable relationship with financial adviser

Advice or advisory privilege is not Control
Removing Donor Restrictions

• With donor consent (see UMIFA/UPMIFA)

• Invoke variance power
  Board decision when a donor’s restriction becomes:
  • Unnecessary
  • Incapable of fulfillment
  • Inconsistent with the charitable needs of the community

• Court action
Donor-Advised Funds

• Definition from Pension Protection Act/2006:
  • Separately identified by reference to the contribution of a donor or donors
  • Owned and controlled by a sponsoring organization
  • Donor, donor appointee, or related party has, or reasonably expects to have, advisory privileges with respect to distributions or investments by virtue of donor’s status as donor
  • Donor does not need to be an individual
Donor-Advised Funds

• Exceptions:
  • Funds that distribute only to a single identified organization or governmental entity
  • Scholarships and awards, if certain guidelines are followed
  • Scholarship “exception” found in IRC 4966(d)
  • Secretarial authority to exempt additional types of funds
Donor-Advised Funds

Key Operational Rules: IRC 4966 & 4967

- No grants, loans, compensation, expense reimbursements, or similar payment to donor, donor adviser, or related party
- No more than incidental benefit* received by a donor/adviser or related party from grantee
- Gift acknowledgment must provide that CF has exclusive legal control over contributed assets
- No “excess business holdings” (IRC 4943(e))
Item 1: Distributions from DAFs for purchase of tickets to charity-sponsored event or to pay for membership fees

Item 2: Distributions from DAFs that grantees treat as satisfying a pledge made by donor

Item 3: Use of DAFs to circumvent “tipping” rules for contributions to smaller charities
**Item 1:** Distributions from DAFs for purchase of tickets to charity-sponsored event or to pay for membership fees:

Treasury and IRS currently view distributions from DAFs for “charitable” portion of event tickets or membership fees as “a more than incidental benefit” to donor and therefore not allowed under § 4967 (no bifurcation)
Item 2: Pledges and DAF Distributions:

The Notice provides that a DAF sponsor (such as a community foundation) need not determine whether a donor/donor advisor has made a pledge before sending a DAF distribution to a charity, and the distribution will not result in an impermissible benefit to the donor/advisor, even if it turns out that the donor did make a pledge to the charity, if the following conditions are met:
1) The sponsoring organization makes no reference to the existence of a pledge when making the DAF distribution;
2) The donor/advisor receives no other benefit as a result of the distribution; and
3) The donor/advisor does not attempt to claim a second tax deduction for the distribution to the charity
IRS Notice 2017-73

“Taxpayers may rely on the rules described in section 4 until additional guidance is issued.”

Caution not to interpret Notice as a green light to begin paying donor pledges with DAF funds, or to market the ability to satisfy pledges with DAF funds to donors – rather assurance that DAF sponsors and donor/advisors will not be penalized for DAF grants that may be used to satisfy pledges if the sponsoring organization was not fully aware of the existence of a pledge or the status of that pledge as an enforceable obligation of the donor.
Item 3: Donor’s use of DAFs to support smaller charitable organizations but avoid “tipping”

Treasury and IRS are considering treating DAF gifts to grantee charities as coming from the individual donor and not the sponsoring public charity and changing the regulations to reflect this (this matters for grantee’s public support test)
Additionally, all anonymous distributions from a sponsoring organization will be treated as coming from one individual.

Exception to this treatment if sponsoring organization specifies that distribution is not from a DAF and no donor advised regarding the distribution
Donor Control:

• Working with Agencies
  • Agency as donor
  • Third party donors
  • Hybrid funds
Agency Endowments

• Legal treatment and rules
  • CF must retain legal ownership of funds
  • No unilateral right to withdrawal

• Accounting treatment
  • FASB 136
Grants to Non-Charities

• Status Pending/Status Revoked/No Status:
  • Allowable from any type of fund if for charitable purpose
  • From any fund type other than DAF with some due diligence
  • From DAF with “expenditure responsibility”
    ✓ Pre-grant inquiry
    ✓ Written grant agreement with special provisions
    ✓ Segregation of funds if noncharity
    ✓ Follow-up reporting from grantee
Grants to Individuals Scholarships

• Defined: Grant to assist individual to pursue education, achieve an objective, or develop a skill
• Many criteria acceptable (geographic, school, or interest)
• If donor, donor appointee, or related person participate:
  • Donor may not control selection committee
  • Donor’s advice is provided only as member of committee
  • CF appoints selection committee
  • Procedures must be approved in advance by board
  • Procedures must be objective and non-discriminatory
• Special rules apply for scholarships to corporate employees or dependents
• Other grants to individuals are also possible
Legal Aspects of Finance and Administration
Sarbanes Oxley for Nonprofits

• Generally intended for for-profit public companies

• Some provisions extended to nonprofit world
  • Records retention/destruction
  • Whistleblower policy

• Conflicts of Interest
  • IRS sample policy
UPMIFA

• Uniform Prudent Management of Institutional Funds Act

• Intended to harmonize UMIFA with UPIA

• Changes:
  • Eliminates UMIFA’s historic dollar-value threshold
  • Guidelines about what spending is prudent
  • Must consider duration and fund preservation

• Adopted or pending in almost all states

• Status and background information: www.upmifa.org
Advocacy

• Restriction on lobbying and political activity key component of IRC Sec. 501(c)(3)

• Participation in political campaigns prohibited

• Lobbying and advocacy must not be substantial part of organization’s activities

• Decide on a reporting method

• Penalties may include loss of exempt status
Cooperative Relationships

• Supporting Organizations (Types I, II and III)
• Fiscal Sponsorships
• Single-Member LLCs
• MOUs
Fiscal Sponsorship

• Fiscal sponsor: public charity that exercises oversight and discretion on the use of grant funds

• Insist on making grants to sponsors who are responsible and accountable and require documentation of relationship