

TOP 10 TIPS FOR NAVIGATING RED FLAGS WHILE LEADING A PRIVATE FOUNDATION

Midwest Family Foundation Webinar Series | Navigating Regulations

Thursday, May 21, 2020



VENTURE3PHILANTHROPY

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ATTORNEYS & COUNSELORS





DONDRE D. YOUNG

*Program Coordinator, Learning Services
Council of Michigan Foundations*

HOUSEKEEPING

- Please note, we will mute all attendees during this meeting.
- We welcome questions. If you have a question for the speakers, please type your question in the Q&A box or raise your hand so that staff may unmute you. Staff members will be monitoring the Q&A.
- This webinar is being recorded. The link to the recording will be sent to all registered participants after the webinar.
- This presentation is for informational purposes only. It does not constitute legal advice and is not comprehensive of every legal aspect involved. The private foundation rules are complicated and depend heavily upon the facts at hand and require consultation with your foundation's advisors.

TODAY'S SPEAKERS



Colleen Mitchell

Founder & Principal
VENTURE3Philanthropy LLC



Jennifer Oertel

Attorney & Member
Bodman PLC



Colleen Mitchell

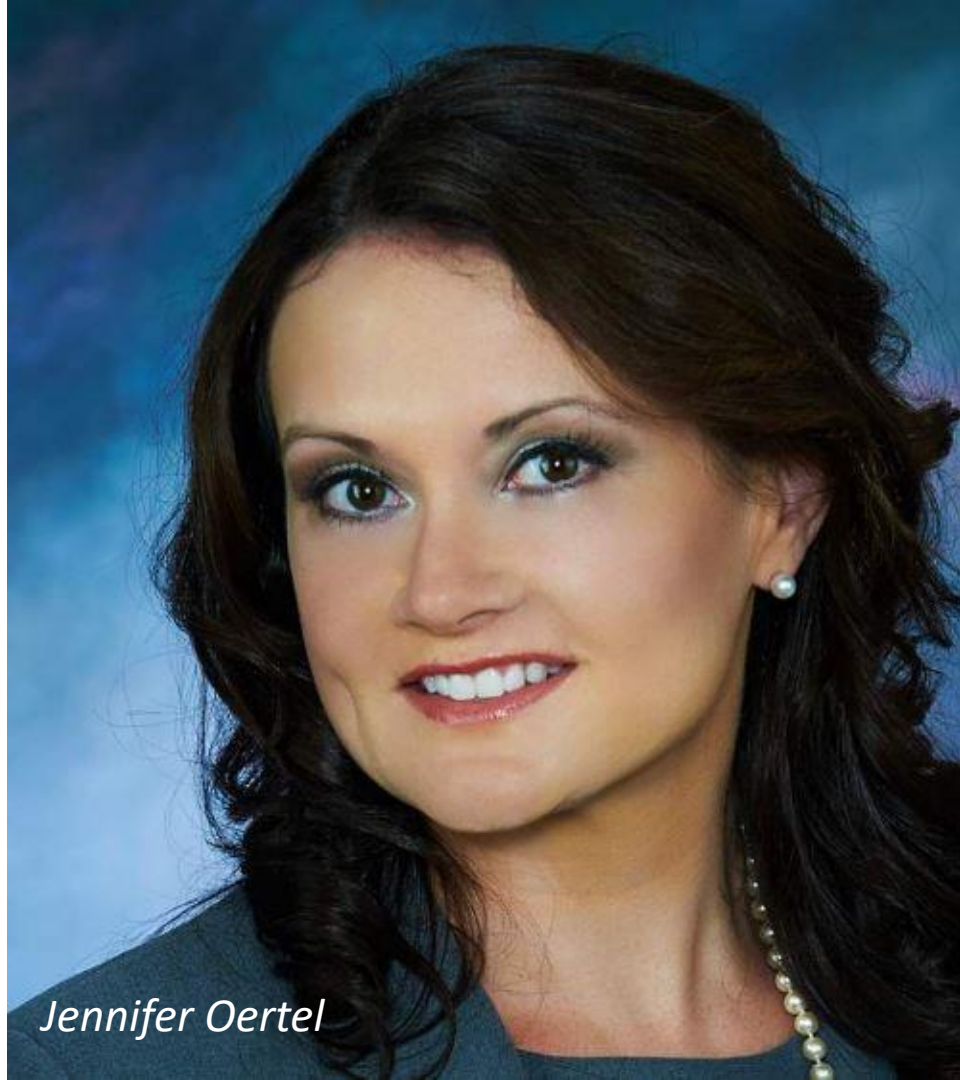
Colleen serves as the founder and principal of VENTURE3Philanthropy LLC, a leading, global philanthropic advisory practice committed to designing giving strategies for the greatest social impact.

Colleen's independence and expertise as a global philanthropic advisor is distinct, utilizing a comprehensive, three-sector lens of public, private, and social sectors in her philanthropic advising service experience.

Colleen has led several private and operating foundations within the social sector, including Whirlpool Foundation, IMCERA Group Foundation, NorthShore Foundation and served her hometown community foundation, The Columbus Foundation.

Jennifer serves as CMF's outside legal counsel and impact investing expert in residence. She also co-chairs the Nonprofit Corporations Committee of the State Bar of Michigan (Business Law Section).

As co-chair of the Exempt Organizations and Impact Investing Practice Group at Bodman PLC, Jennifer utilizes her background in corporate and securities law and governance, combined with her knowledge of exempt organizations law, to assist family and corporate foundations, community foundations, public charities, regional associations, trade and labor associations, chambers of commerce, religious organizations and other tax-exempt organizations as well as impact investors, impact funds, and social enterprises, in all aspects of their business



Jennifer Oertel

Tip #1 Avoid Self Dealing



- An IRS prohibition intended to uphold the integrity of the foundation & its activities for the common good.
- Prohibits most transactions between a private foundation and Disqualified Persons (DP), even if it could be beneficial to the Foundation.
- Financial penalties rendered to recipient DP and any foundation managers who knowingly approved the transaction.

Tip #1 Avoid Self Dealing



1. Is it a prohibited transaction?

- Sale, exchange or leasing of property
- Lending of money or other extension of credit
- Furnishing of goods, services or facilities
- Payment of compensation or payment or reimbursement of expenses
- Transfer to, or use by or for the benefit of a disqualified person any income or assets of the private foundation
- Agreement to pay a government official

Tip #1 Avoid Self Dealing

2. Does it involve a Disqualified Person?



- Officers, directors, trustees and others with similar authority
- Substantial contributors (anyone giving more than \$5000 if that amount is greater than 2% of total contributions in period from inception to end of taxable year in which received)
- Individuals or entities owning at least 20% of entities that are substantial contributors
- Family members of any of the above (spouses, ancestors, descendants and their spouses, anyone legally adopted but excluding siblings)
- Any corporation, partnership or trust of which any DP holds more than 35% of the beneficial interest
- Certain government officials

Tip #1 Avoid Self Dealing



3. Does an exception apply?

- No interest, no-fee loans (but only TO foundation by DP)
- Provide something to foundation for free
- Payment of REASONABLE COMPENSATION for PERSONAL SERVICES REASONABLY NECESSARY TO CARRYING OUT EXEMPT PURPOSES. Personal services = professional and managerial in nature, such as foundation professionals, legal, investment advice and accounting – not outside real estate broker or lawn maintenance (likely not pure secretarial assistance, but the case law varies)

Tip #1-A Can't Satisfy Personal Pledges



- Paying a legally binding debt, promise, or financial commitment made by a Disqualified Person is not permitted.
- Family trustee pledges are personal and private obligations.
- Clear, documented policies are recommended.

Tip #1-B Caution Attending Ticketed Fundraisers

- Any tangible benefit received by trustees by using foundation-paid tickets is considered self-dealing.
- Attending a ticketed event on behalf of a foundation is permissible only when evaluating or monitoring a grant activity.
- Do not “bifurcate” or “split the costs.”
- Giving tickets to an outside individual/entity that’s not a charity is a non-charitable purpose.
- Program sponsorship or acknowledgment is permissible, goodwill.



Tip #1-C Ensure Reasonable Compensation For Necessary Activities

- Board - yes, uncommon, but only with reasonable compensation; can also pay reasonable expenses.
- Hiring family members - yes, if professional and managerial, only with reasonable compensation; can also pay reasonable expenses.
- Family travel expenses- only upon legitimate foundation duties; expenses paid for others are treated as income.
- NextGen training - IRS ruling and guidance affirmative on foundation paying learning expenses, but this is a very narrow exception.



Tip #2 Caution with Grants to Individuals



- IRS special rules on grants to individuals for travel or study; never to Disqualified Persons
- Grantee selection procedures must be preapproved by the IRS if foundation making the selection to ensure objectivity & nondiscrimination; avoid “ear-marking.”
- Scholarships, prizes, awards typically given as grants to public charities to create the entire selection process.
- Not all payments to individuals are “grants” but may be payment for services rendered to the foundation.

Tip #3 Follow Special Rules

- **Grants to organizations that are not charities** - permitted if for a charitable purpose; following “expenditure responsibility” rules.
- **Using a fiscal sponsor** - permitted if grant supports a 501 (c) (3) that has complete control over the way the funds are granted, typically to a charitable project or group that does not have a 501 (c)(3) status but is conducting charitable activities.



Tip #4 Grants to International Organizations



Private foundations are permitted to make grants to international organizations by either of the following IRS tests:

- Equivalency Determination: An affidavit based on facts and supported by documentation
- Expenditure Responsibility

Or foundations may utilize a “friends of” organization

Tip #5 Learn to Spot Prohibited Lobbying Activities

Lobbying or influencing legislation occurs when the foundation contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting, or opposing legislation, or if the organization advocates the adoption or rejection of legislation.

Legislation includes action by Congress, any state legislature, any local council, or similar governing body, with respect to acts, bills, resolutions, or similar items (such as legislative confirmation of appointive office), or by the public in referendum, ballot initiative, constitutional amendment, or similar procedure.

Tip #5-A Exceptions to Prohibited Lobbying Activities

There are exceptions for “self-defense lobbying,” where the legislation affects the existence of the private foundation, its powers and duties, its tax-exempt status or the deductibility of contributions to such foundation.

This exception does not apply to grassroots lobbying (encouraging others to contact legislators), and it doesn’t apply to issues of self-defense of a foundation’s grantees.

Lobbying does not include actions by executive, judicial, or administrative bodies.

Lobbying does not include nonpartisan analysis, study, and research, technical advice or assistance, or examinations and discussions of broad social, economic, and similar problems.

Consult counsel if you intend to rely upon an exception or with respect to voter registration drives.

Tip #6 Dispose of Excess Business Holdings

- Purpose of this prohibition is to prevent tax-exempt organizations from using charitable assets to control private businesses.
- Private foundation (plus Disqualified Persons and related parties) may not own more than 20% of the voting stock of a corporation (or profits in a partnership); 35% if business is controlled by independent party. Not triggered unless foundation itself owns 2% of the entity's stock.
- Exceptions for functionally related business, Program Related Investments, passive income, and the “Newman’s Own” exception.



Tip #7 All Assets Must Be Classified & Valued

- Foundation's asset value determines how much money must be distributed annually (payout) in Qualifying Distributions - grants, necessary and reasonable administrative costs, direct charitable activities, and some acquisition of assets.
- Required to **annually** make **Qualifying Distributions** of at least **5%** of the foundation's net investment assets from the preceding year.
- With IRS approval via a private letter ruling (PLR), A foundation may set aside funds for up to 60 months for certain major projects.
- A foundation that fails to pay out the 5% distributable amount annually is subject to a 30 percent excise tax under section 4942 on the undistributed income. An additional 100 percent tax is triggered if the foundation fails to make up the deficient distribution within 90 days of receiving notification from the IRS of its failure to make minimum distributions.



Tip #8 Submit IRS Documents On Time

Form **990-PF** **Return of Private Foundation**
 or Section 4947(a)(1) Trust Treated as Private Foundation

Department of the Treasury
 Internal Revenue Service

OMB No. 1545-0052
2016
 Open to Public Inspection

► Do not enter social security numbers on this form as it may be made public.
 ► Information about Form 990-PF and its separate instructions is at www.irs.gov/form990pf.

For calendar year 2016 or tax year beginning _____, 2016, and ending _____, 20

Name of foundation _____ A Employer identification number _____

Number and street (or P.O. box number if mail is not delivered to street address) _____ Room/suite _____ B Telephone number (see instructions) _____

City or town, state or province, country, and ZIP or foreign postal code _____ C If exemption application is pending, check here

G Check all that apply: Initial return Initial return of a former public charity
 Final return Amended return
 Address change Name change

D 1. Foreign organizations, check here
 2. Foreign organizations meeting the 85% test, check here and attach computation

H Check type of organization: Section 501(c)(3) exempt private foundation
 Section 4947(a)(1) nonexempt charitable trust Other taxable private foundation

E If private foundation status was terminated under section 507(b)(1)(A), check here

I Fair market value of all assets at end of year (from Part II, col. (c), line 16) ► \$ _____ J Accounting method: Cash Accrual
 Other (specify) _____ F If the foundation is in a 60-month termination under section 507(b)(1)(B), check here

Part I Analysis of Revenue and Expenses (The total of amounts in columns (b), (c), and (d) may not necessarily equal the amounts in column (a) (see instructions).)

(a) Revenue and expenses per books	(b) Net investment income	(c) Adjusted net income	(d) Disbursements for charitable purposes (see instructions)

- Tax return on Form 990 PF is due on the 15th day of the 5th month after the fiscal year ends (except for 2020, due to COVID-19).
- Most states have Attorneys General and corporation annual filings and reporting requirements, as well.
- Additional filings for employment taxes, unrelated business taxable income and the like.

Tip #9 Make Your Tax Payments!

Excise - the new Taxpayer Certainty and Disaster Tax Relief Act of 2019, replacing the two-tiered system with a flat rate of 1.39% effective tax year 2020.

Payroll - If a foundation as a tax-exempt organization (EO) has employees, the EO is responsible for Federal Income Tax Withholding and Social Security and Medicare taxes.



Tip #10 Keep Adequate Records

Maintain the following records, at a minimum:

- Financial transactions related to investments, income, and expenses;
- All grant records;
- Minutes of all board and committee meetings;
- Foundation tax returns;
- Form 1023 – Application for Exemption
- Foundation staff employment records;
- Leases, capital purchases, sales;
- Special IRS approved activities, such as expenditure responsibility.

Foundations are required to provide 3 years of tax returns and their Form 1023 and IRS Determination Letter to any member of the public upon request.



Impact Investing

What is it?

- A means of using capital to drive financial value and social and/or environmental impact simultaneously.

Why?

- Grants hopefully generate social impact, but a -100% financial return (especially key during a down market)

5%/95%

- Our investments may be supporting the social issues that our donations aim to solve
- Program related investments count toward the 5% even if funds will be repaid

For more information please see michiganfoundations.org, services, impact investing



COVID-19 Related Legislation Overview

- During a federally declared major disaster, there is some loosening of restrictions on payments to employees of a related corporation.
- Extension of filing deadline for 990-PF and 990-T until July 15, 2020
- CARES Act stimulus package
- [CMF's website](#) has extensive resources updated in light of the constantly evolving situation



Q&A



EVALUATE US!

Your feedback is important – our quick online evaluation can be completed in 3 minutes or less!

Save the Date!

MIDWEST FAMILY FOUNDATION WEBINAR SERIES
SUCCESSION PLANNING
NOVEMBER 12, 2020
(HOSTED BY PHILANTHROPY OHIO)



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THANK YOU!

STAY IN TOUCH WITH CMF

