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UPCOMING WEBINARS

- **Insights from the 2017 Investments and Endowments Study** **AUG 29**
- **Philanthropy Law in India**
AUG 30
- **Awoke to Woke to Work: Building a Race Equity Culture** **SEPT 5**
- **Global Goals: Innovative Approaches to Driving Impact at US Companies**
SEPT 19
- **ER Causing You Trauma? Diagnosing the Rules and Regulations for Expenditure Responsibility** **SEPT 26**

UPCOMING COUNCIL EVENTS

- **Inclusive Economic Prosperity Midwest**
Minneapolis, MN — **AUG 28-29**
- **Endowment & Finance Summit**
Washington, DC — **SEPT 6-7**
- **HR Summit**
Denver, CO — **SEPT 12-13**
- **Legal Matters for Community Foundations**
Hartford, CT— **SEPT 27**
- **Legal Matters for Community Foundations**
Spokane, WA— **OCT 11**
- **CFE Fundamentals**
Jacksonville, FL— **OCT 24-25**

Lunch with Legal Counsel: Community Foundations

You Can Take it to the Bank:
Community Foundations & Legal Control Over Agency Funds



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DISCLAIMER

This presentation does not provide legal, tax or financial advice. Consequently we urge you to seek the advice of your own legal, tax or financial professionals in connection with exemption organization matters. This communication (including any attachments or handouts) is not intended or written to be used and cannot be used, for the purpose of avoiding tax-related penalties.



Agenda

- Important Alpha Numeric Sequences
 - The Nature of the Component Fund
 - Legal Consideration in Operating Agency Funds
 - FAAEFQs
 - Questions
-



Important Alpha Numeric Sequences





3.14159265359...



Golden Text of the Bible

John 3:16



Jenny's Number

867-5309





Component Fund

Treas. Reg. § 1.170A-9(f)(11)



Component Funds

The Nuts & Bolts to
1.170A-9(f)(11)





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



§ 1.170A-9 Definition of section 170(b)(1)(A) organization.

...
(f) Definition of section 170(b)(1)(A)(vi) organization

...
(11) Community trusts; requirements for treatment as a single entity

...
(ii) Component part of a community trust. In order to be treated as a component part of a community trust referred to in this paragraph (f)(11) (rather than as a separate trust or not-for-profit corporation or association), a trust or fund:

(A) Must be created by a gift, bequest, legacy, devise, or other transfer to a community trust which is treated as a single entity under this paragraph (f)(11); and

(B) May not be directly or indirectly subjected by the transferor to any material restriction or condition (within the meaning of § 1.507-2(a)(7)) with respect to the transferred assets . . .



§ 1.170A-9 Definition of section 170(b)(1)(A) organization.

...
(f) Definition of section 170(b)(1)(A)(vi) organization

...
(11) Community trusts; requirements for treatment as a single entity
(i) General rule.— [A]ny organization that meets the requirements [. . .] of this section will be treated as a single entity, rather than as an aggregation of separate funds . . . [and] will be treated as component parts of such organization.

Irrevocable Transfer

No take-backs, no do-overs!

~ Little Johnny, Third Grader

§ 1.170A-9 Definition of section 170(b)(1)(A) organization.

...

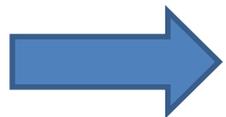
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(A) Must be created by a gift, bequest, legacy, devise, or other transfer to a community trust which is treated as a single entity under this paragraph (f)(11); and



(B) May not be directly or indirectly subjected by the transferor to any material restriction or condition (within the meaning of § 1.507-2(a)(7)) with respect to the transferred assets . . .



(A) **Must** be created by a **gift, bequest, legacy, devise, or other transfer** to a community trust which is treated as a single entity under this paragraph (f)(11);
and

SEE Comm’r v. Duberstein, 363 U.S. 278 (1960).

A gift in the statutory sense, on the other hand, proceeds from a ‘detached and disinterested generosity,’ . . . ‘out of affection, respect, admiration, charity or like impulses’ . . . And in this regard, the most critical consideration, as the Court was agreed in the leading case here, is the transferor’s intent. 363 U.S. @ 285.

Internal Revenue Code § 102 “Gifts”

Recipient to have complete dominion and control



Legalese

(B) May not be directly or indirectly subjected by the transferor to any material restriction or condition (within the meaning of § 1.507-2(a)(7)) with respect to the transferred assets . . .

Plain English

A restriction or condition cannot prevent Community Foundation from freely and effectively employing assets or income in furtherance of its exempt purpose.



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



The Hallmark of Community Foundations

- To modify any restriction or condition on the distribution of funds for any specified charitable purposes or to specified organizations **if in the sole judgment of the governing body . . .** Such restriction or condition becomes, in effect, **unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served**

Practice Point for Agreement Drafting:

- Permissive ✓
- Compulsory ✗



- ✓ Thanks, but no thanks.
- ✓ The Foundation shall have the ultimate authority and control over all property in the Fund, and the income derived from it, in accordance with the Articles of Incorporation and Bylaws of the Foundation (as they may be amended from time to time), and the terms of this Agreement, applied in a manner not inconsistent with said Articles and Bylaws.



What is an Agency Endowment?

A Primer



“Agency Endowment” generally refers only to funds at a community foundation that were established by a **charity** that designated ***itself*** as the beneficiary.*



* Differentiate from a Designated Fund



Benefits

To Charity

- Help ensure continuity of programs
 - Provide resources to meet emergencies and occasional financial deficits
 - Frees charity from administrative burdens, while turning responsibility for asset investment and administration to foundation staff who are more skilled in this activity
-
- To Community Foundation
 - Adds to financial support to maintain qualification as publicly supported organization under IRC § 509



Legal Considerations in Operating an Agency Endowment



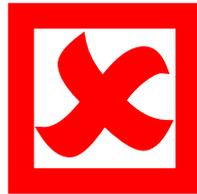
- Securities Laws
- Unrelated Business Income Tax (UBIT)
- Fiduciary Duties
- FASB



Securities Laws

- Federal and state securities laws generally do not pose any problems when a charity manages *its own* investments
- Where charity retains legal ownership of the fund (or is revocable), but simply transfers its assets to community foundation, foundation is said to be investing *someone else's* money
 - EXCEPTION: Where CF exempted by state's securities laws

Unrelated Business Income Tax



Agency endowments will not generate UBIT since managing one's *own investments* is not a trade or business



Fiduciary Duties

- Community foundation directors have a fiduciary obligation to exercise due diligence and loyalty
- Because assets in agency endowment funds *are* the property of the community foundation, these duties do not change



FAS

The Financial Accounting Standards Board requires funds for a designated charity be accounted for differently, depending on whether gifts to the fund came from individual 3d party donors or from the designated charity

Foundation Life in the FAS Lane

Fund Type	Contribution Revenue	Liability or Net Assets
Designated Fund	Yes	Net Assets
Agency Endowment	No	Liability

“Hybrid” Funds

Combination of donations from unrelated 3d party donors AND transfers from the charity

- Portions attributable to 3d parties
 - Contribution revenue & net assets
- Portions attributable to transfers from charity
 - Not contribution revenue & liability





Frequently Asked Questions



Q1 – Charity Creditors?

Can creditors of a charity with an agency endowment fund at a community foundation seize or reach into the fund to satisfy a judgment?



Q1 – State Specific

- Generally, no. Once assets have been given away, creditors have no claim on them because they are no longer the donor's property
- Operating Assumption: Transfer of property by charity to foundation not done to defeat interests of creditors



Q2 – Fund as Loan Collateral?

Can a bank use an organization's agency fund as collateral for a loan with that bank?



Q2 – Yes, provided . . .

- Community foundation's board approves; AND
- Not prohibited under the terms of fund agreement

However . . .

- Bank should understand exactly what interest organization is pledging, AND
- Organization's interest is subject to (and possibly limited by) the terms of the fund agreement



Q3 – PF Agency Funds?

Can a private foundation establish an agency fund at a community foundation?

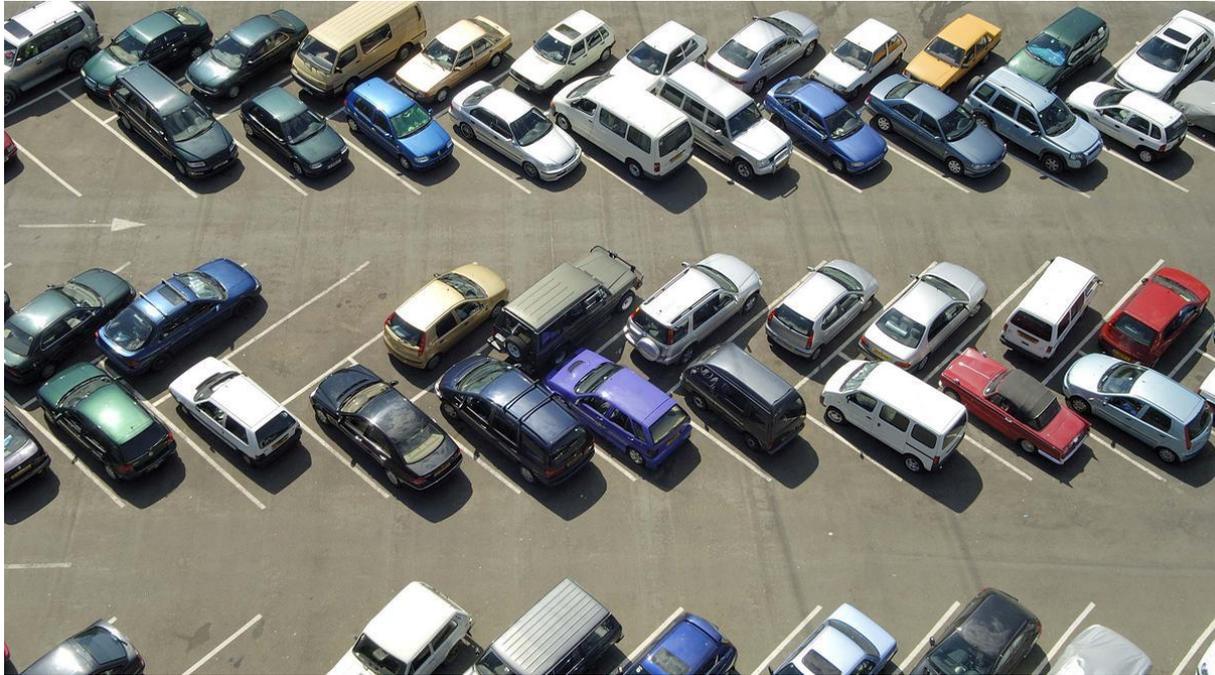


Q3 – Operating PFs Can

- COF Legal suggests including language in the fund agreement to address what would happen to the fund if the PF ever fails to qualify as a private operating foundation



The Concern: Parking Funds





Q4 – Agency Funds for Local Gov't?

- Can a department of a local government, for example, County Sheriff, establish an agency fund at the community foundation?



Q4 – It Depends

- Check your local laws. Some municipal or state laws prohibit governmental entities from making permanent transfers of money to an endowment fund



Questions???

