Keeping Your Corporate Foundation Compliant

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Many companies establish a corporate foundation to further their philanthropic objectives because of this vehicle’s distinct advantages. Corporate foundations can foster increased brand recognition, customer loyalty and goodwill, and improved employee morale. They enable consistent levels of giving in years both lean and flush by building up reserves when company profits are high. Moreover, corporate foundations can engage in charitable activities such as scholarship programs, hardship and emergency grants to individuals, and international giving that would not be tax deductible as charitable donations or charitable expenditures if handled directly by the company.

Unfortunately, corporate foundations don’t always receive the attention and expertise they need to stay in compliance. Many are managed by individuals who have other jobs within the company. It is also not uncommon for a company’s founder and key executives to have important or leading roles in the corporate foundation. No matter how dedicated, competent, or visionary these managers might be, their primary focus is on the company. As such, they may find it challenging to keep up with IRS regulations and are therefore less likely to spot potential compliance issues before they become difficult to unwind.

Having a dual role also can make it challenging to keep the company’s foundation operations and objectives separate from its primary business. This is of serious concern because the tax-favored status of private foundations, whether they are established by an individual or a company, is conferred with the expectation that they will operate exclusively for charitable purposes. The corporate foundation’s activities must further these charitable objectives, whether or not such objectives advance the company’s commercial interests.

For more than a decade, Foundation Source has supported companies with the administration and management of their foundations. In our experience, there are several key areas where corporate foundations may inadvertently stray into noncompliance. The practices discussed below might attract the interest of the IRS because they could violate private foundation tax rules that were enacted as a result of the perception of past abuses by foundation insiders or “disqualified persons.” Being aware of the following compliance issues is of particular importance because even the mere suggestion of impropriety has the potential to damage a company’s reputation.

- **Sharing of Staff, Office Space, and Business Equipment:** Companies often donate office space, equipment, and staff to their foundations, rather than seek reimbursement or attempt to share expenses. The tax rules prohibit foundations and their disqualified persons from entering into financial transactions with each other, such as lease arrangements, unless certain narrow exceptions apply. Companies that fund their foundations are usually subject to these tax rules because they are considered to be
“substantial contributors,” a type of disqualified person. In this context, the tax rules permit a company to lease office space at no charge to its company foundation. What is less known is that a corporate foundation that leases space at no charge may, under certain conditions, be able to pay its fair share of related expenses for its use. For example, the foundation may be able to pay a percentage of the utility bill provided that they pay the utility company directly and not their for-profit parent company. We recommend that companies consult counsel before making any such arrangements.

- **Recognition for Grants:** Grantee organizations often thank their corporate donors by giving them public recognition for their generous support. Sometimes the company itself is acknowledged for donations made through the corporate foundation. Even though this sort of public recognition and goodwill benefits the company, it should not result in self-dealing violations because the benefits to the company generally are considered to be merely “tenuous and incidental.” However, companies need to be careful: Public recognition is one thing; but advertising the company’s services, products, or facilities as a result of the foundation’s donation is quite another. If corporate foundation grants are used to obtain advertising for the company’s for-profit business, a self-dealing violation may result because the benefit to the company could then be more than merely tenuous and incidental.

- **Self-Dealing:** In the course of carrying out foundation operations, company employees may be presented with an opportunity to benefit personally from a grant made by the company foundation. For instance, a grantee may provide free concert tickets to the corporate foundation, which, in turn, may wish to distribute the tickets to company employees who are unaffiliated with the foundation. This situation should be avoided because a self-dealing violation may result. There is some flexibility if a foundation’s own employees, officers, or directors attend an event on the foundation’s behalf with a specific charitable task in mind, such as monitoring a grantee’s performance, conducting a site visit, or showing support for the grantee by attending an event. However, if a company wishes to show its support for a charity by buying a table at an event and filling it up with company employees and their spouses who are unconnected to the foundation, then the company itself, rather than the foundation, should make this purchase.

- **Compensation:** Corporate foundations are permitted to have paid employees carry out their missions, particularly if their charitable activities are time-consuming or complex. If employees are compensated, the foundation should follow best practices by ensuring that the services rendered are necessary and professional in nature, and that the proposed compensation is reasonable. Reasonableness of compensation can be established by a process known as “benchmarking,” which entails comparing the proposed compensation arrangement to compensation paid by similarly situated foundations and service providers. Naturally, an employee who is paid by both the corporate foundation and the company should not render services to the company while on the foundation’s “clock.” A company may provide services to its foundation for a reasonable fee, like any other paid service provider, if the services rendered are necessary and represent “personal services,” which are generally professional in nature.

- **Employer Scholarship Programs:** Private foundations may receive permission from the IRS to offer scholarships directly to needy individuals and even, under certain conditions, to its own employees and children of employees. However, it is important to note that special rules apply when a company provides scholarships to its employees, officers, and directors, and their children through its foundation’s “employer-related scholarship program.” These rules are intended to prevent a company from improperly using its foundation’s scholarship program as a back-door way to recruit and retain employees, and to increase the value of benefits and compensation provided to the company’s employee base. For example, the rules require that scholarship recipients be selected by an independent committee composed of individuals who are not connected
to the company or the company foundation and who are not former employees of either entity. The rules also restrict the number of scholarship grants that may be awarded on an annual basis. To prevent the corporate foundation from granting scholarships to every eligible applicant, thereby effectively making the scholarship into an employment benefit, the foundation may award the scholarships only to a percentage of eligible applicants.

While manifesting themselves in different ways, the practices of compliant corporate foundations should mirror the practices of well-run companies: clarity of purpose, transparency, and independent transactions without conflicts of interest. Because vigilance around these areas of sensitivity is vital to the company’s brand as well as the success of its philanthropic endeavors, many companies engage an outsourced service provider, such as Foundation Source, to ensure that their foundations are compliant.

**About Foundation Source (www.foundationsource.com)**

Foundation Source is the nation’s largest provider of comprehensive support services for private foundations, bringing unparalleled knowledge and expertise to clients across the country. The company’s administrative services, online foundation management tools, and philanthropic advisory services provide a total outsourced solution for private foundations. The result: better-run, more effective foundations and more enjoyable philanthropy. Our clients supply the funds, the vision, and the philanthropic goals; we provide everything else.

Today, Foundation Source provides its services to more than 1,100 family, corporate, and professionally staffed foundations, of all sizes, nationwide. The company provides its services directly to philanthropically focused families and institutions as well as in partnership with the nation’s leading private wealth management firms, law firms, and accounting firms. Foundation Source is headquartered in Fairfield, Connecticut, with offices in Dallas, Denver, Los Angeles, New York City, Philadelphia, San Francisco, South Florida, Washington, D.C., and Winston-Salem.