

Protecting Assets of a Separate Supporting Foundation

07.03.17 | Linda J. Rosenthal, JD



The philanthropic sector includes much more than the simple model of a single 501(c)(3), publicly supported, charitable organization.

A fairly common variation, especially for prominent community institutions, is to establish a separate organization which goal it is to support the main charity. Indeed, it is created and exists “solely to support one specific nonprofit corporation.” The Internal Revenue Service recognizes several different types of “supporting” foundations or organizations; it’s important to know which one your organization has created. We’ll have more on that in future posts.

While there are clear advantages to this arrangement – or it would not be used in the first place – there are some possible downsides that, with prudent planning, can be avoided or minimized.

Separation From the Supporting Foundation

Trouble may arise if and when the main charity experiences financial problems, especially sudden challenges arises from outside circumstances beyond the charity’s control.

“If the nonprofit runs into financial trouble, a lack of separation between the charitable foundation and the nonprofit could result in the foundation being on the hook for the nonprofit’s debts.” Creditors might try to satisfy debts owed to them by the charity out of the assets of the supporting foundation.

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It is in both the foundation’s and the nonprofit’s best interests to take steps to limit the possibility of the nonprofit’s debts becoming the debts of the foundation (i.e., to preserve the assets for the desired charitable purpose).

The best strategy is preventive: to create and maintain some amount of separation between the two entities. There are several possible ways to work toward that goal.

Distinct Boards

The most logical way, at first blush, to structure the boards of so-called related organizations is to have identical or interlocking boards of directors. But that would defeat any argument that the entities were separate from each other, and the one should not be held liable for the debts of the other. “If the same board controls the foundation and the nonprofit, it creates the perception that they are effectively operating as one entity.”

The correction to that problem would be appointment of a different set of directors for each of the entities. That will support a finding that one is not controlled by, or responsible for, the other. As a practical matter, though, having two entirely different boards could create its own difficulties sufficient to decide not to take this path. As in most organizational endeavors, the success of such an approach might depend on the personalities and skills of the people occupying these directorships.

Secondary Beneficiary

If the arrangement is structured so that a single supporting foundation is set up to help more than a single charity, the foundation’s assets may be more protected. Second, consider designating a second beneficiary for the supporting foundation. “If the foundation supports both Charity A and Charity B, and Charity A encounters financial distress, the foundation could more persuasively argue that it is not merely an extension of Charity A, but rather, an independent foundation with obligations to both charities.”

Prohibit Access

Another device to avoid contaminating the foundation’s assets with the problems of the supported charity is to create a bylaws restriction limiting the charity’s unlimited access to the assets of the foundation. This might “strengthen the argument that the two are separate, independent entities.”

In this regard, there are two ways to structure the restriction: (1) insert a bylaws provision that the foundation can only distribute funds to the charity “at the foundation’s discretion”; or (2) write the foundation’s bylaws so that the charity receives only a limited, specific support amount each year;

for instance, “income earned on the foundation’s assets without any access to principal.”

Conclusion

After considering all of the pertinent facts and circumstances of the particular situation, and considering a “level of protection that is appropriate based on them, it may be concluded that the “increased administrative and operating costs” of maintaining the suggested separateness is not worth the trouble.