

Resolving Trustee Disputes: Foundation Split-Ups & Other Approaches

STATE BAR OF TEXAS
**Governance of Nonprofit
Organizations Course**
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What Causes Conflict and Disputes Among Trustees?

- Misunderstandings
- Lack of clear organizational/management structure
- Differences in values, goals, priorities and expectations
- Conflicts of Interest
- Disruptive Directors
- Director/Trustee issues/misconduct outside boardroom
- Bad motives within the boardroom



Avoiding (or Limiting) Disputes: Good Governance Policies

- Mission Statement
- Code of Ethics
- Conflict of Interest Policy
- Roles & Responsibilities
- Whistleblower Policy



Mission Statement

- Statement that captures in succinct terms why the organization exists
- Used as a North Star to align goals and priorities
- Closely related to values statement/Code of Ethics

Code of Ethics

- Expectations of Board/Officers/Employees
- Organization's ethical standards
- Should be regularly reviewed
- Encourages ethical behavior
- Gives process to the values of the organization
- Aligns expectations of board members

Conflict of Interest Policy

- Coordinate policy with provisions of organizational documents and other policies for consistency in process, priorities and expectations.
- Draft with state and federal laws in mind
- Be careful to define terms that have no obvious meaning or meanings that differ from one statutory provision to another (e.g., disqualified person, manager, etc.).
- Consider Advanced Resignation Protocol.
- Policy should clarify consequences for violation up to and including removal and pursuit of legal remedies.

Roles & Responsibilities

- Board Commitment Form
 - Reflect organization's value and culture while aligning expectations
- Maintain legal & ethical integrity of organization
 - Clarify fiduciary responsibilities of board members
- Ensure development of resources
- Specific responsibilities of Board members
 - Meeting attendance
 - Active participation
 - Job description
 - Term limitations

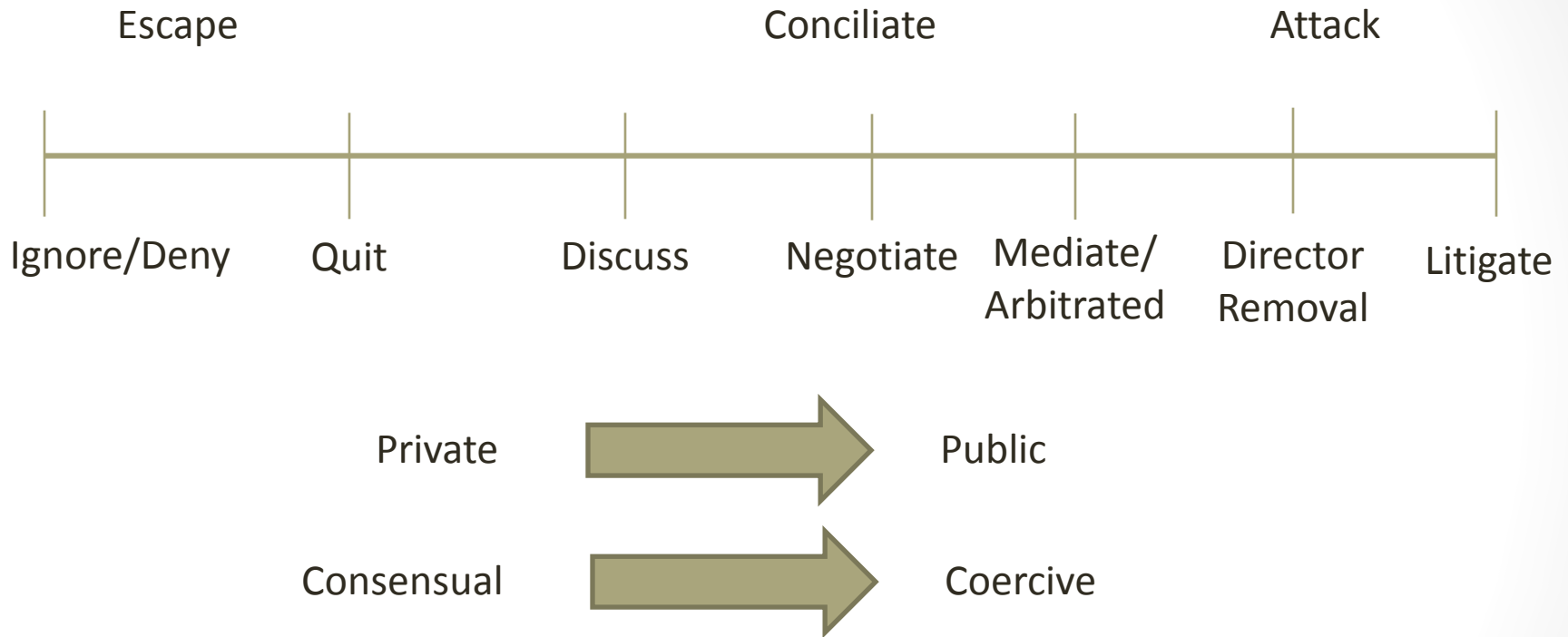
Whistleblower Policy

- Effectively an extension of Code of Ethics
- Enable foundation to handle complaints internally first
- Should include:
 - Who is covered by policy
 - Types of issues which should be disclosed
 - Reporting mechanism
 - Anonymous reporting option
 - Must act in good faith, with reasonable grounds for report
 - No harassment/retaliation

Avoiding Disputes: Good Governance Practices

- Selection process of new Board members
- Training of new Board members
- Re-training of current/returning directors
- Proper Board composition
- Defined structure in place to deal with disputes
- Bylaws
 - Process on removing/replacing Trustees

Responses to Conflict



Adapted from Peacemaker Ministries

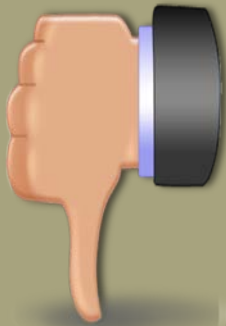


Escape Responses: Ignore or Quit



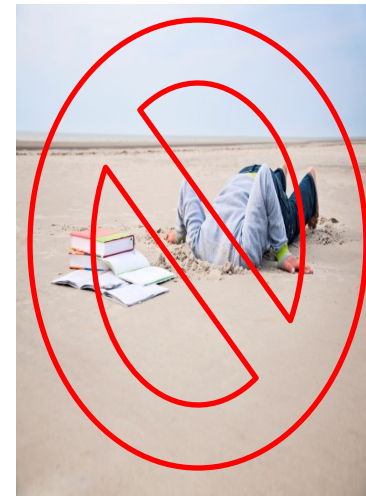
When is this appropriate?

- Personal offenses
- Differences in values, goals, priorities, expectations
- But split-up is not an option (dispute is minor or harm to organization)



When is this inappropriate?

- Disruptive director
- Bad motives
- Discovery/allegation of director wrongdoing
- Harm to the organization



Conciliation Responses

- Have designated conflict manager
 - Skilled board chair, vice chair or past board chair/member
 - Conflict management skills, viewed as impartial
- Hearing Process
 - Use of Subcommittee
 - Use of full Board
- Disruptive Directors
 - Periodic governance evaluation procedures
 - Bring in third-party facilitator/counselor
 - Escalating scale up to removal of director

Conciliation Responses

- Use of Outside Advisor can be instrumental, especially when dealing with related parties (family foundations)
- Conflict Management Training
 - Communication skills
 - Listening
 - Assertion
- Conflict Management Facilitator
 - Facilitate discussion of issues
 - Participants are treated fairly
 - Promotes team spirit
- Third Party Dispute Resolution
 - Mediator
 - Arbitrator



Attack Responses



Attack Responses: Director Removal and/or Litigation

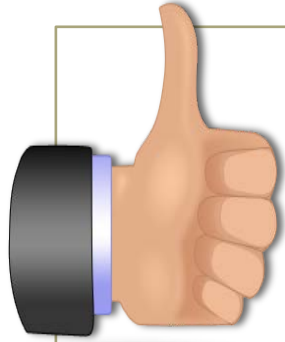
When is this appropriate?

- Breach of duty (typically duties of care/loyalty)
- Continued disruptive behavior following conciliatory responses
- In accordance with Bylaws
 - Example: Conviction of crime of moral turpitude

When is this inappropriate?

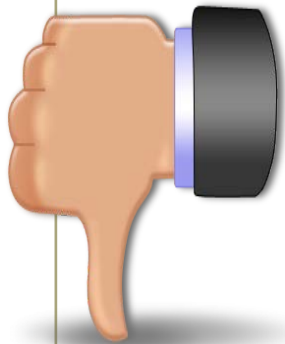
- Personal offenses, misunderstandings
- As the first option in non-breach of duty conflict

Dealing with Irreconcilable Differences: Split-Ups



When is this appropriate?

- Conciliation through a negotiated split
- Examples



When is this inappropriate?

- When used as an escape response

Split-Ups & Termination

- Must distribute assets to another 501(c)(3)
 - Or will be “taxable expenditure” under §4945
- “Termination” under §507 is of the foundation’s status under federal law, not of the existence of the foundation itself under state law
- Options:
 - Distribution of all assets to qualified public charity(ies)
 - Automatic termination under § 507(b)(1)(A)
 - Distribution of assets to Donor Advised Fund
 - If meet the rules of § 507(b)(1)(A), foundation’s status is terminated
 - Can voluntarily terminate under § 507(a)(1)
 - Split Up among private foundations
 - Either terminate voluntarily or continue existing foundation

Distribution to Public Charities

- Foundation can terminate its status under § 507(b)(1)(A)
- Distribute all assets to one or more public charities, which has been in existence (& so qualified) for at least 60 months prior
 - Cannot impose material restrictions on transferee organization(s)
 - Foundation automatically terminated
 - Not liable for termination tax under § 507(c)
- If transferee organization(s) not in existence for 60 months, or is a 509(a)(2) or (a)(3) organization, foundation's status is not terminated
 - Same result if public charity becomes PF within 3 years of transfer
 - Must terminate under § 507(a)(1), if wish to terminate
- Should file final 990-PF with IRS, and comply with any state law requirements

Distribution to Donor Advised Fund

- Foundation can distribute all of its net assets to one or more DAFs
- If the sponsoring charity meets requirements of a qualified public charity under § 507(b)(1)(A), foundation's status automatically terminates
 - If the sponsoring charity does not meet those requirements, PF can choose to remain, as donor advisor, or choose to terminate under § 507(a)(1)
- Benefits of terminating into a DAF :
 - Family can remain involved, to extent desirable
 - Sponsoring charity assumes responsibility for governance/management
 - Family's legacy can be continued
 - Better income tax charitable deduction

Split Up – to Private Foundations

- Foundation may choose to transfer all assets to one or more private foundations
- Transferee foundation(s) generally inherit the characteristics of the transferor
- Foundation's status not automatically terminated
 - If wish to dissolve, must follow § 507(a)(1) to terminate
- Includes a partial liquidation of assets or other significant (i.e. 25% or more) of its net assets
- If transferee foundation(s) is commonly controlled, then transferee is treated as if it is the transferor, for purposes of Ch. 42 and §§ 507-509
- Transferor must still file 990-PF & include its liquidation/dissolution plan as attachment

Voluntary Termination - § 507(a)(1)

- To voluntarily terminate a private foundation's status, the organization must notify the Secretary of its intent to terminate
 - Filing 990-PF marked "final" is not enough
- Must pay termination tax under § 507(c)
 - Should be zero if have distributed all assets
- A transfer of all of the foundation's net assets does not result in termination, unless done pursuant to § 507(b)(1)(A)
 - Foundation still in existence – potential ramifications if gift made to the foundation in later years
- Must file final 990-PF for the taxable year
- If want to continue operations later, must re-apply for exemption as a 501(c)(3)
- Remember: state law dissolution requirements

Tax Consequences

- § 507(a)(1) termination does not relieve terminating foundation or DP from tax liability under Ch. 42
- To terminate under § 507(b)(1)(A), foundation cannot have committed act/failure to act causing tax liability under Ch. 42
 - Transferor remains subject to Ch. 42 until has distributed all net assets to qualified charities
- If transferring assets to other private foundations (§507(b)(2)), transferee liability applies
 - If transferring to commonly controlled foundation, transferee(s) is treated as if it is the transferor – DP carry over
- Consider prohibited transactions (Pages 36-43)

The information set forth in this outline should not be considered legal advice, because every fact pattern is unique.

The information set forth herein is solely for purposes of discussion and to guide practitioners in their thinking regarding the issues addressed herein. Non-lawyers are advised to consult an attorney before undertaking any issues addressed herein.

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