Structuring of Affiliated and Cooperative Organizations
AFFILIATED ORGANIZATIONS
ISSUES IMPORTANT TO PUBLIC UNIVERSITIES

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Gerald Woods
FisherBroyles, LLP and Augusta University
Augusta, GA

Patrick J. McKenna
Georgia Institute of Technology
Atlanta, GA

1. Independently incorporated organizations may be created to help public universities:
   a. Raise funds to benefit the university and to manage the university’s endowment
      and manage alumni associations,
   b. Contract with outside entities for research grants and contracts,
   c. Handle intellectual property developed by faculty and manage institutional
      technology transfer activities,
   d. Operate or manage academic programs in foreign countries,
   e. Purchase and develop (and perhaps operate) real estate to benefit the university,
      or
   f. Operate athletic associations and manage athletic programs.
2. Vigilant university counsel will monitor the affiliated organization’s actions to assure
   that all activities using the name of the university are conducted in accordance with state
   laws governing nonprofits and are consistent with their fiduciary duties and in
   compliance with the Internal Revenue Code and IRS regulations and other applicable
   federal laws and regulations regarding such matters as federal grant awards and contracts
   as well as private foundation grants documents. Similarly, adherence to the requirements
   of the NCAA, outside accrediting bodies, or other relevant entities should be monitored.
3. The following are examples of items university counsel should check periodically: 1
   a. Is there a license agreement governing the affiliated organization’s use of the
      university’s name, logo or trademark in any of its activities? Does the agreement
      give the university full authority to prohibit uses it believes are not in the
      university’s best interest and to terminate the relationship if necessary? Is there a
      system in place for the university to approve and monitor usage?
   b. Is the affiliated organization properly organized and operated in compliance with
      state laws regarding such things as annual registration as a nonprofit corporation,
      registering for the solicitation of funds (where applicable), and maintaining
      corporate minutes, filing its annual IRS form 990 return for tax exempt
      organizations, and complying with IRS rules regarding the reasonableness of
      executive compensation?

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c. Does university counsel have copies of the articles of incorporation and bylaws and any amendments thereto? Does university counsel have a copy of the IRS Determination Letter establishing the tax exempt status of the organization and any follow up communications from or with the IRS affecting that status?

d. In the case of real estate development involving the issuance of tax exempt bonds, does the organization keep university counsel informed during bond issuance activities and does university counsel work with the organization after bonds are issued and property leased to the university to assure that the Internal Revenue Code and IRS regulation limitations on private use of facilities are followed?

e. Is the affiliated organization properly insured and have copies of insurance documents been provided to university counsel? Is the university named as an additional insured? Is the organization’s insurance coverage coordinated with that held by the university to assure no gaps in coverage and that the interests of the university are covered adequately, especially where real estate is involved, but in other areas as well.

f. Has university counsel reviewed all agreements between the organization and the university and retained copies of final agreements? Are copies of all audits and financial reports provided to the university? Do the agreements require full cooperation from the organization for the university to comply with the generally accepted accounting principles that require for reporting the finances of affiliated entities on the university balance sheet, and is the university required to cooperate with the entity in its preparation of financial reports and audits?

g. Is the relationship between the university and the organization sufficiently arm’s length to assure that the organization can withstand a challenge to its independent corporate status? If university employees perform services for the organization, do agreements define roles clearly and assure that the university is properly compensated under state law for services provided, whether in-kind or actual payments? If university board members, administrators or staff serve on the organization’s board of directors, are they periodically educated on their fiduciary responsibilities in their respective roles and on conflicts of interest principles?

h. Does the organization have a policy on conflicts of interest, as recommended by the Internal Revenue Service, and does organization management monitor and report to their board conflicts of interest on the part of its directors, officers, and employees? How is university counsel apprised if such conflicts are found to exist?

i. Is the organization adequately capitalized and are transfers of funds between the university and the organization properly documented and supported by proper consideration to meet state law requirements?

j. Has the university issued policies or guidelines on the acceptance of gifts by its affiliated organizations and is the entity in compliance? Does the entity understand clearly that it may accept gifts to the organization but not those made to the university by name?

k. Does the operating agreement between the organization and the university assure that the organization cannot accept gifts imposing obligations on the university without prior university approval?
l. Are all gifts, transactions, and real estate acquisitions and dispositions and the financing thereof, reported to the university in a timely manner?

m. Is an athletic association working closely with the university such that all commitments under NCAA rules are met and violations reported and handled appropriately with university counsel participation?

n. What is the relationship between counsel for the entity and counsel for the university? Is university counsel asked from time to time to give advice to the entity? If so, have policies to prevent counsel conflicts of interest been implemented?

o. How is donor information handled and does state law allow nondisclosure? Is the affiliated organization in compliance with those laws and are they informing donors properly about the legal disclosure requirements?

p. Is the entity subject to the state’s open records (freedom of information) and open meetings laws and are they in compliance with those laws (e.g., public notices of board of directors’ meetings)?

q. For affiliated organizations that manage relationships with and collaborate with community organizations, other universities, and other entities, is there a process to monitor those activities and their impact on the university and its mission?
RESOURCES

1. For additional information, see the NACUA CLE outline prepared by Paul J. Ward, then Vice President for University Administration and General Counsel at Arizona State University, on “Compliance by Affiliated Foundations and Other Related Entities” for the 2007 NACUA Annual Conference.

2. The University System of Georgia Cooperative Organization Policy is a useful example of policies governing the relationships between public universities and affiliated organizations. See http://www.usg.edu/policymanual/section12/C1768 and its Memorandum of Understanding requirements for such organizations at http://www.usg.edu/business_procedures_manual/section17/C1533.

3. See this publication by the Association of Governing Boards on university-affiliated organizations: http://agb.org/trusteeship/2014/11/governing-boards-and-university-affiliated-organizations-risks-and-rewards. This article by John T. Casteen is based upon a report created by a commission appointed by the AGB.

   “The work of the commission distinguished four types of affiliates:
   a. University medical centers, athletics foundations, and university foundations. Often large, resource-intensive, and burdened with potential risk, these can pose complex fiduciary challenges for governing boards.
   b. Auxiliary units, revenue-generating units, and contracted service providers. These serve students and staff on the campus, often without direct competitors. Many are licensed by the governing board.
   c. Partner organizations—local, state, and federal governments, private foundations, community groups, private corporations, and others. Often ad hoc, distinct accommodations to surrounding environments, these neighbors, physical or other, do great good but can also pose frequent challenges. Governing boards may have little control over them, and yet these entities may claim or expect a great deal in exchange for their benevolences.
   d. Grassroots groups of students, alumni, or faculty; philanthropies; charitable service providers; and other supporters of university work. These are emergent groups whose members may feel strongly attached to the institution and empowered to act on its behalf, whether or not the board knows about them and their positions.”

4. Other valuable Association of Governing Boards publications and videos can be found at www.agb.org, such as:
   a. “Illustrative Memorandum of Understanding Between a Public Institution or System and an Affiliated Foundation:
   b. “Bringing the Foundation and Host Institution Together” (video)
   c. “Avoiding Conflict of Between the Foundation and Host Institution’ (video)
   d. “Aligning Foundation and Institution Goals” (video)
   e. “Shared Decision-Making Between Foundations and Institutions” (video)
   f. AGB Draft Statement on Institution – Foundation Relationships (March 2016)

5. A good overview of control verses independence issues is a paper, “Public University and Affiliated Foundation Relationships: Balancing Control and Autonomy”, by Rebecca Cady, which can be found at http://www.educationlawconsortium.org/forum/2005/papers/cady.pdf.
Synopsis: The decision to form an affiliated organization arises from a desire for distance between a university and some activity, related or unrelated for tax purposes, which the university wishes to foster. This distance may engender a level of independence that creates legal, reputational or political issues for the university.

A university policy with respect to such entities may help articulate the relationship between the parent and its affiliates, by addressing core issues: conflicts of interest, private benefit and inurement, standards of director care, corporate formalities, and the permissible level of institutional involvement in the entity. But such a policy must not serve as a road map to those who might seek to disregard the entity by “piercing its veil.”

Creative lawyering can achieve policy goals implicitly through the selection of an appropriate type of entity, thoughtful handling of relevant tax issues, and the articulation of core issues in the affiliated organization’s governing documents. Such measures will help strike the delicate balance between adequate university oversight and a reasonable measure of entrepreneurial freedom for the subsidiary, all without subjecting the university to liability to the subsidiary, its shareholders or creditors, or to the loss of tax benefits which often lead to the creation of the subsidiary.

It is also essential that those asked to serve as officers and directors of such entities understand the obligations flowing from their roles and that they be afforded appropriate protection from liability in their individual capacities. Maximizing director insulation may also shield the university from liability in the event that the director is deemed to act in a representative capacity for the parent institution.

In the case of more distant entities, the university should have its counsel review the governing documents of the affiliated entity to assure that adequate protections are in place. The benefits from affiliated entities need to be weighed against the legal and administrative burdens they entail and the potential misunderstanding that such entities can create in the institution’s public and alumni constituencies.

Part I of this outline provides a broad overview of the fundamental legal issues that should be considered by a university considering the establishment of an affiliated entity, whether in the US or abroad; Part II discusses legal issues of particular importance to US universities seeking to undertake activities abroad and foreign universities planning to expand their reach into the United States. While this outline attempts to touch on the relevant issues for the purpose of discussion and further research, it does not purport to be a comprehensive treatment of this extensive subject.
PART I: FUNDAMENTAL ISSUES IN THE UNIVERSE OF AFFILIATES

1. Basic Requirements for Affiliates

For both federal tax and state law purposes, the formation of the entity should be designed so that its integrity as a separate entity is respected. Corporate disregard, treated in Section 2 below, which is sometimes referred to as the problem of “piercing the corporate veil,” is the worst possible outcome for such subsidiaries or affiliates (which terms are used interchangeably here). The requirements for federal tax and state law purposes have enough in common that satisfying the tax tests will often amount to satisfying the state law tests.

a. Federal Tax Requirements for Entity Formation

The IRS applies a two-part test for bona fide subsidiaries. First, the subsidiary must possess a separate business purpose. Second, it must not act merely as an agent or instrumentality of the parent.

i. Separate Business Purpose. The IRS will require that an exempt or taxable entity have a separate business purpose.

A 1999 IRS Private Letter Ruling captures these principles and the cases that IRS deems to illustrate them:

“For federal income tax purposes, a parent corporation and its subsidiaries are separate taxable entities so long as the purposes for which the subsidiary is incorporated are the equivalent of business activities, or the subsidiary subsequently carries on business activities. Moline Properties Inc. v. Commissioner, 319 U.S. 436, 438 (1943) [43-1 USTC ¶ 9464]; Britt v. United States, 431 F. 2d 227, 234 (5th Cir. 1970) [70-1 USTC ¶ 9400]. That is, where a corporation is organized with a bona fide intention that it will have some real and substantial business function, its existence may not generally be disregarded for tax purposes. Britt, 431 F.2d at 234 [70-1 USTC ¶ 9400]. However, where the parent so controls the affairs of the subsidiary that it is merely an instrumentality of the parent, the corporate identity of the subsidiary may be disregarded. Krivo Industrial Supply Co. v. National Distillers and Chemical Corp., 483 F.2d 1098, 1106 (5th Cir. 1973).”

The IRS has held that a bona fide, exempt purpose, in the case of an exempt affiliate, also satisfies this requirement:

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2 IRS Priv. Ltr. Rul. 9940148 (July 20, 1999) (for-profit subsidiary created to manage assets held by its parent, an exempt supporting organization itself created to hold short-term assets of a private university, possesses a valid and distinct business purpose). Private letter rulings are technically not binding on the IRS as precedent but are commonly used to predict how the IRS will treat analogous facts.
“We do not believe that this requirement that the subsidiary have a bona fide business purpose should be construed to require that the subsidiary have an inherently commercial or for-profit activity. The term ‘business’, as used in the context of this test, is not synonymous with a ‘trade or business’ in the sense of requiring a profit motive.” ³

One commentator has summed this requirement up as follows: “Virtually any business purpose other than reducing federal income tax will satisfy the business purpose requirement.” ⁴ (emphasis added) Reducing tax is, however, a legitimate secondary purpose.

ii. Subsidiary Must Not Act as the Instrument or Agent of the Parent. Whereas the first test is easily satisfied, the IRS tends to focus its attention on whether, despite its separate purpose, the subsidiary’s day-to-day affairs are so dominated by the parent that its separate identity should be disregarded.⁵ The relationship between parent and subsidiary must not become a true principal-agency dynamic.⁶ The evidentiary test for agency or instrumentality seems to be substantially identical to that applied in state law veil piercing cases.⁷ The standard of proof is high: clear and convincing evidence is required.⁸ As in the state law cases, substantial overlap between parent and subsidiary is tolerated if the entities are managed separately:

“Control through ownership of stock, or the power to appoint the Board of Directors, of the subsidiary will not cause attribution of the subsidiary’s affairs to the parent. We do not believe that the *** GCM should be read to suggest, by negative inference, that when the Board of Directors of a wholly-owned subsidiary is made up entirely of Board members, officers or employees of the parent there must be attribution of the affairs of the subsidiary to the parent. The extent to which the parent is involved in the day to day management of the subsidiary is the factor which must be considered, along with the bona fide and substantial business purpose of the subsidiary, in determining whether or not the subsidiary is so

³ IRS Gen. Couns. Mem. 39598 (Jan. 23, 1987) (the failure of a real estate holding company to qualify for 501(c)(3) status, due to the private benefit it conferred upon physicians, did not impair the exemption of its exempt hospital parent, because the subsidiary possessed a bona fide, separate existence).
⁵ See, e.g., IRS Priv. Ltr. Rul. 200518081 (May 6, 2005) (“In general, a parent corporation and its subsidiary are separate taxable entities so long as the purposes for which the subsidiary is formed are for a business purpose. Hence, the ownership of a subsidiary by an organization exempt under Section 501 does not require attribution of the subsidiary’s activities to the parent for federal income tax purposes unless the subsidiary lacks a business purpose, and the subsidiary is an arm or agent of the parent.”).
⁷ Blumberg & Strasser, supra note 1.
⁸ Id. See also IRS Gen. Couns. Mem. 39326 (Aug. 31, 1984) ( “…the activities of a separately incorporate subsidiary cannot ordinarily be attributed to its parent organization unless the facts provide clear and convincing evidence that the subsidiary is in reality an arm, agent or integral part of the parent.”).
completely an arm, agent or integral part of the parent that its separate corporate identity is properly disregarded.”

The issue of separate tax identity matters even if the subsidiary will be treated as a pass-through or conduit for tax purposes for several reasons. In the event that the activities of the subsidiary constitute a substantial, unrelated trade or business, the entity veil may help shield the university from intermediate sanctions, recognition of Unrelated Business Income Tax (“UBIT”) or, horror of horrors, loss of its exemption.

The IRS will generally permit the board of the parent organization to provide general policy guidelines for the operations of the subsidiary, and this provides a safe avenue for the university to articulate – in appropriately general terms – the permissible activities of the subsidiary. Similarly, the fact that the university retains control over significant corporate actions of the subsidiary, like dissolution, will generally not jeopardize the subsidiary's separate identify.

2. State Law Requirements; Piercing the Veil

States generally respect separate entity personas, even within corporate families, so long as the subsidiary’s independence of its parent is evident from its operations. Courts permit the corporate form to be disregarded on the basis of the related theories of instrumentality, identity, agency and alter ego, all of which rely on factual determinations that the subsidiary’s operations are so dominated by the parent that the subsidiary is not genuinely separate.

All of these theories look to whether the corporate formalities have been observed and whether the entities are operationally distinct but, in most jurisdictions, a showing of fraud or injustice is also required. The factors courts hold establish identity between entities are overlapping officers and directors, common shareholders, financial support of subsidiary by the parent, underwriting of incorporation by parent, grossly inadequate capital structure, shared accounting and payroll systems, shared use of resources without compensation, favorable treatment of parent by subsidiary by officers and directors with joint appointments, operational

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10 See, e.g., NCAA v. Comm'r, 92 T.C. 456 (1989), rev'd on other grounds, 914 F.2d 1417 (10th Cir. 1990) (advertising activities of publisher attributed to NCAA for UBIT purposes where contract between NCAA and publisher designated the publisher as agent and where NCAA effectively controlled the publisher's commercial activities). For an excellent discussion of these issues and the panoply of tax concerns relevant to subsidiaries of exempt organizations, see Randolph M. Goodman & Linda A. Arnsbarger, Trading Technology for Equity: A Guide to Participating in Start-Up Companies, Joint Ventures and Affiliates, PROCEEDINGS OF THE NEW YORK UNIVERSITY 27TH CONFERENCE ON TAX PLANNING FOR 501(C)(3) ORGANIZATIONS (1999).


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integration, commingling of funds, or guarantee or payment of subsidiary debts by the parent without adequate consideration.  

These concerns apply equally to non-corporate entities, such as general and limited partnerships and limited liability companies. Some practitioners believe that the lack of experience and case law on limited liability companies make them more vulnerable to veil challenges, but this may evince an excessive conservatism. Exempt affiliations, such as supporting organizations, are sufficiently unusual that courts may disregard them more easily than stock subsidiaries. In one instance, the Connecticut Attorney General convinced a court that the assets of an unrepresented, supporting organization were subject to attachment in the receivership proceedings of the parent, an insolvent hospital.

3. Importance of Corporate “Formalities”

Whether the entity in question is a close or distant affiliate of the university, the observance of corporate formalities is crucial to limiting the university’s potential exposure to the liability to the affiliate or its creditors. The following should be required of all affiliates which the university forms or on which university officers sit in a representative or quasi-representative capacity. (Obviously, the list should be modified to meet the requirements of the state under which the particular entity is governed):

- **Regular Meetings.** Affiliates, like the nonprofit world generally, are beset with the misconception that their stepchild nature or mission to perform good deeds entitle the entity to a lower standard of corporate compliance than is expected of their for-profit cousins. Discourage this tendency. At least one actual meeting of the directors (not a unanimous resolution of the directors in lieu of a meeting) should be held annually or as more frequently required by relevant law.

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14 See WILLIAM D. BAGLEY & PHILIP P. WHYNOTT, THE LIMITED LIABILITY COMPANY § 7:20 (2nd ed. 1999); O'NEAL & THOMPSON, supra note 12, at § 8.23 (“Thus, all the statutes replicate the long-standing insulation provided by corporate law to passive providers of capital and to active participants for liability arising from the acts of others...Indeed some courts seem oblivious to any difference between a corporation and an LLC.”).

15 See Randall M. Skigen, A Cautionary Tale: Bankruptcy and Independent Supporting Charity, 26 CONN. LAW TRIB. 3, pp. 9A-10A (Jan. 1, 2000). In a subsequent proceeding by the hospital under § 7 of the Bankruptcy Code, the bankruptcy trustee argued, among other things, that the supporting organization’s assets should be consolidated with the hospital’s because the affiliate had been unjustly enriched with free use of the parent’s name and space for a gift shop in the hospital’s building. But see In re Lease-A-Fleet, Inc., 141 B.R. 869 (Bankr. E.D. Pa. 1992) (refusing to apply the doctrine of “substantive consolidation” to a supporting organization whose supported organization was party to bankruptcy proceedings).

16 These suggestions are substantially less burdensome than those which banks and rating agencies typically require for bankruptcy remoteness. See Moody's Investors Service, Bankruptcy Remoteness Criteria for Special Purpose Entities in Global Structured Finance Transactions, STRUCTURED FINANCE TRANSACTIONS (October 7, 2014); Standard & Poor's Ratings Services, Legal Criteria for US Structured Finance Transactions: Special-Purpose Entities, RATINGSDIRECT (October 1, 2006).

17 In addition to the sources cited supra note 9, see ZOLMAN CAVITCH, 9 BUSINESS ORGANIZATIONS WITH TAX PLANNING § 120.05[2] (1997).
o **Maintain Minutes, Make Filings.** Minutes should be maintained in an organized way, and annual state filings should be processed in a timely way to maintain the legal existence of the entity and prevent dissolution by forfeiture (if applicable), and state, local and federal tax returns should be filed appropriately and on a timely basis. Part of the trick here is to clearly establish whether professionals for the affiliate and the university will handle these functions at the entity level, by an outside service (e.g., CT Corporation), by the university or in close coordination. Coordination is particularly necessary in the case of exempt subsidiaries whose returns are consolidated with the university’s return.

o **Maintain Indicia of Separate Persona.** The subsidiary should maintain separate bank accounts, use distinct letterhead, and be careful that funds are not commingled and that infusions of capital or loans between the entities are documented. Where appropriate, the subsidiary should also have a separate mailing address, telephone number, and separate office space.

o **Directors and Officers Should Act in Interest of Subsidiary.** Directors should be made aware of their duties (see Sec. 5 below) and adopt a conflict of interest regime (see Sec. 6 below) that directs them to act in the best interest of the subsidiary, particularly where there are competing interests between the parent and subsidiary. Outside directors (those with no formal role in management of the parent) are useful to address conflict issues; the key is to select directors who will remain sensitive to the university’s concerns. But complete identity of officers and directors, while not optimal, is not in itself prohibited by state entity or federal tax provisions.

o **Shared Facilities and Resources.** All intercorporate exchanges of goods and services should be documented and on an arm’s length basis, both for tax reasons and to instill accountability in the subsidiary’s managers. Particular care should be given to shared space use. Private letter rulings indicate that the IRS is particularly sensitive that space use by affiliates in buildings of the parent be reimbursed at market rates. This concern is especially salient in the context of non-exempt subsidiaries. Care should also be taken that such shared use, if placed in facilities built with tax-exempt financing, does not violate bond covenants or relevant tax provisions governing the financing, or local property tax provisions. If the tax concerns permit occupancy by the subsidiary, a lease or license agreement is also a good tool to maintain a respectful distance between the entities.

o **Shared Employees.** There is no prohibition on an affiliated organization engaging the available capacity of its parent's employees; however, particular care should be taken to ensure that the arrangement is properly documented and accounted for. Compensation paid to shared employees should be fairly allocated between organizations and evidence of the time actually devoted to each organization's matters should be logged as a matter of course. Combining subsidiary employees with parent employees for administrative purposes, including pooling employees for health insurance purposes, has been specifically approved by the IRS.
o License University Name and Logos. If the affiliate will use the name and/or logos of the university, the use should be pursuant to a bona fide license agreement. Termination of the agreement at the discretion of the parent upon certain triggering events can prevent misuse of the trademarks in the event that the affiliation becomes attenuated. Power to revoke can also be a substantial point of leverage should the affiliate become too independent. Adequate consideration should support the license.

4. Avoiding Private Inurement and Intermediate Sanctions

Use of university assets for the benefit of the affiliate without adequate compensation can result in unintended private benefit or private inurement problems. Compensation paid to directors or officers of affiliates by the affiliated organizations, taken together with compensation paid by the university, should be scrutinized to avoid compensation which exceeds the “reasonable” amount permitted by the IRC § 4958 and the Treasury Regulations thereunder set forth (the so-called “intermediate sanctions”), which allow the IRS to impose an excise tax on prohibited transfers to “disqualified persons” (i.e., insiders) by exempt organizations when the more drastic step of revoking the organization’s exemption is not warranted.\(^\text{18}\)

Common transactions that may implicate the intermediate sanctions regime include an organization paying excess compensation, certain revenue sharing arrangements, making loans bearing below-market interest, making services available on a preferential basis and purchasing property for more than its fair market value.\(^\text{19}\) These “excess benefit transactions” are punished in the first instance by a 25% excise tax imposed on the disqualified person. If the violation is not corrected within a specified period, a punitive 200% excise tax applies. An additional 10% excise tax may be imposed on organization managers who participate in the excess benefit transaction knowing it is improper.

Both parent and affiliate organizations should proactively identify individuals with substantial influence over organizational decisions and should pay special attention to compensation and other transactions with such individuals. A rebuttable presumption of reasonableness can be established for compensation arrangements with disqualified persons where such arrangements are approved by an independent committee, are based on appropriate comparability data and are adequately documented in writing.\(^\text{20}\)

5. Duties of Directors

It is important to encourage any person serving on the board of an affiliated organization to become familiar with the basic duties of corporate directors, so that they can discharge their obligations, particularly when conflicts arise. In many cases, those called to serve on the boards of affiliated entities have had little or no prior boardroom experience, such as the faculty member

\(^{18}\) See Hill & Kirschten, supra note 4, at § 2.03[3][c] (“Any flow of value resulting in tangible or intangible, direct or indirect benefit to a person other than the foundation and the charitable class that properly benefits from the performance of its exempt activities should be analyzed as a potential source of inurement.”).


\(^{20}\) Treas. Reg. § 53.4958-6(c).
who serves on the board of a technology start-up or the university officer who serves on a the board of regional charity. Many reliable written guides for directors are available. The content of the director’s duties will be found in the corporate laws of the jurisdiction governing the entity. While director’s duties vary according to each jurisdiction’s statutory and common law, most recognize the two cardinal duties:

a. **Duty of Care.** This duty requires the directors to use the same care in the discharge of the company’s affairs that a prudent person would use under similar circumstances. Although directors of charitable institutions have historically been held to a higher standard of care than stock corporation directors, this trend is definitely in decline. To oversimplify a little, if directors observe the duty of care, they are shielded from liability for bad business judgments so long as they are not grossly negligent in reaching them. The duty of care can be understood as a duty of each director to familiarize him or herself with the entities’ governing documents, monitor its finances, review relevant materials prior to making decisions, regularly prepare for and attend board meetings and delegate tasks requiring special competency to reliable professionals.

i. **Business judgment rule.** This rule is corollary of the duty of care that acts not as a standard of conduct, but of judicial review. It insulates a director from liability when he or she has made a business decision with disinterest, independence, due care, good faith and without abuse of discretion, fraud or illegality and creates a presumption in favor of the director. The business judgment rule extends to nonprofit boards in many jurisdictions.

b. **Duty of Loyalty.** This duty requires a director to give the corporation his or her undivided loyalty, which in turn prohibits use of the directorship for personal gain at the expense of the corporation. This obligation prohibits a director from appropriating for

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21 See, e.g., AMERICAN BAR ASSOCIATION GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS (George W. Overton, ed., 3d ed. 2013).
23 Commentators often invoke Justice Benjamin Cardozo for the proposition that the fiduciary duties of nonprofit directors more closely resemble, or resembled in past times, those of trustee: “A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilirio of an honor most sensitive, is then the standard of behavior.” Meinhard v. Salmon, 249 N.Y. 458, 464 (1928). See also Gordon H. Marsh, Governance of Non-Profit Organizations: An Appropriate Standard of Conduct for Trustees and Directors and Other Cultural Institutions, 85 DICK. L. REV. 4 (1981) (arguing against the trustee standard).
24 See, e.g., Morrell v. Wellstar Health Sys. Inc., 633 S.E.2d 68 (Ga. Ct. App. 2006) (“In general, corporate principles are applied to resolve questions concerning the function of nonprofit corporations because the functions of their directors are virtually indistinguishable from those of their pure corporate counterparts.”). See also, Daniel L. Kurtz & Jill Laurie Goodman, Duties and Liabilities of Directors of Charitable Organizations, NON-PROFIT ORGANIZATIONS: CURRENT ISSUES AND DEVELOPMENTS, TAX LAW AND ESTATE PLANNING COURSE HANDBOOK SERIES, 217 PLI 219 (1984).
25 BLOCK, BARTON & RADIN, supra note 21, at 134 et seq.
26 Pamela A. Mann, Nonprofit Governance: Duties, Conflicts and Liabilities, CURRENT ISSUES IN ADVISING NONPROFIT ORGANIZATIONS, NEW YORK PRACTICE SKILLS COURSE HANDBOOK SERIES, 34 PLI 7, 31-34 (1997).
27 BLOCK, BARTON & RADIN, supra note 21, at 110.
28 Pamela Mann, op. cit. at 12.
29 See generally BLOCK, BARTON & RADIN, supra note 21, at 261 et seq.
his or her own profit a corporate opportunity and implies that the director shall keep confidential any information gained as a director. Most of the obligations implicit in the duty of loyalty can be addressed with a thoughtful policy governing conflicts of interest.

6. Conflicts of Interest

Whether the affiliate is close or distant, the adoption and maintenance of a conflicts of interest policy should be a requisite of university involvement in the entity. Many good examples of conflict policies are available, including one promulgated in the Continuing Educational Program of the IRS. Conflicts of interest arise when a director or participant in a venture finds that his or her self-interest conflicts with his or her duty of loyalty to the entity. Some of the most vexing conflicts involve a simultaneous, conflicting duties to separate entities, as when an officer holds concurrent roles in both a parent and an affiliate organization. In the case of title-holding entities or other wholly owned or controlled affiliates, there is more confluence of interest than conflict of interest between the goals of the organizations. But confluence has its costs. Directors with dual appointments at the subsidiary and the parent must be careful not to use their subsidiary appointment for the benefit of the parent at the expense of the subsidiary.

Therefore, adoption of a conflicts policy would seem as advisable for close affiliates, as for distant ones, as an indication of entity separation. In the case more distant affiliates, such as technology start-ups engaged in commercialization of university-based research whose goals may at some point be at odds with those of the university, it may be critical to have not only a policy but also outside directors in order to effectively address conflicts. An adequate conflict of interest policy will provide, at minimum, for the following:

- annual, written disclosure of conflicts by each director to a designated officer;
- a procedure for dealing with conflicts once they arise, usually by excluding the interested party from deliberations and decisions in which they are conflicted;

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31 Originally issued as part of the FY 1997 CEP materials, the policy was reissued in slightly revised form as IRS Document 97-28166 (May 22, 1997), 96 Tax Notes Today 198-223. Subsequent revisions have been made to a version of the policy included with the materials accompanying IRS Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, most recently revised in October 2013. Although the IRS model policy was initially directed to healthcare organizations, the policy is suitable template to begin with for drafting policies for other exempt entities as well.


33 Block, Barton & Radin, supra note 21, at 376, note that the “directors of a subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and the parent’s shareholders,” and that the “parent corporation does not owe a fiduciary duty to its wholly owned subsidiary.” This observation should be tempered with the equally important obligation of the directors to maintain the separate corporate identity of the subsidiary.

34 The proportion of outside directors should increase if the purpose or operations of the affiliate could threaten the university’s exemption if the affiliate is disregarded. Hill & Kirschten, supra note 4, at § 9.03[2][b].
o procedures for evaluating the fairness of transactions with insiders or with affiliated organizations;
o written documentation of all conflict inquiries;\textsuperscript{35}
o incorporation of any relevant state law provisions on conflicts; and\textsuperscript{36}
o a clear statement regarding confidentiality.

A conflicts policy is also advisable for affiliates that take the form of partnerships or limited liability companies, whose partners or members, as the case may be, are often held to owe a higher fiduciary standard toward one another than directors owe to a corporation.\textsuperscript{37} It is increasingly common to see limited liability companies appoint a board of managers to manage the company’s day to day activities, and to install an appropriate policy to address conflicts with respect to these boards as well the company’s members.

7.  **Limits on Director Liability**

Counsel should try to assure that the affiliate shields its directors from personal liability to the maximum extent legally permissible. At a minimum, the following should be investigated:

o Check that the entity has adopted the most liberal standard for indemnification of its directors allowed by the state of incorporation. Often this will require amendments to its charter.
o The Volunteer Protection Act, 42 U.S.C. §§14501 et seq., offers limited immunity to a volunteer (i.e., unpaid) director or officer of a 501(c)(3) organization from his or her non-negligent conduct or decisions that may cause harm to third parties (but does not shield the director from liability to the entity itself).
o Some states also provide additional immunity from civil liability to charitable directors.\textsuperscript{38}
o Recommend that the affiliate purchase director/officer insurance, in cases where the affiliate’s activities make this a cost-effective use of funds.
o In certain cases, service of a university official on an outside board may be covered by the university’s director/officer policy. Before relying on university coverage, however, consideration should be given to whether invoking such coverage undermines the separateness of the two entities.

8.  **Choice of Entity**

A variety of entity types may be employed for subsidiaries, subject to state law requirements and IRS constraints. The range of business and tax issues which govern the choice of entity in a particular circumstance go well beyond the scope of this outline. However, the following are some basic issues to consider:

\textsuperscript{35}HARPOOL, supra note 29.
\textsuperscript{36}KURTZ, supra note 23, at 11, notes that less than half of the states have statutory provisions for resolving conflicts. Where applicable, though, state standards can be significant. For example, the New York Nonprofit Revitalization Act of 2013 contains N.Y. N-PCL § 715, which requires organizations to adopt particularly in-depth conflict policies and to obtain annual reports from applicable individuals.
\textsuperscript{37}FLETCHER, supra note 31, at § 84.20; BAGLEY & WHYNOTT, supra note 14, at § 7:50.
\textsuperscript{38}See, e.g., CONN. GEN. STAT. § 52-557m.
a. Corporate Affiliates. A common form is a wholly-owned or controlled subsidiary nonstock entity of which the university is the sole member, or a stock entity of which the university is the sole shareholder. In either case, the university will retain control (at least on paper) of the entity’s activities, and the organizing documents (or relevant law) may require member or shareholder consent for fundamental changes or undertakings. Accomplishing control can have adverse tax consequences. If 50% or more of the entity board seats or stock is held by the university, the affiliate will be deemed a “controlled subsidiary” for the purposes of §512(b)(13) of the Code and rent, interest or royalties paid by the subsidiary to the university will usually be subject to UBIT. (Such upstream payments should, if possible, be characterized as dividends, which are not subject to UBIT.)

If corporations are used, strong preference should be given to exempt entities over taxable ones, for governance as well as tax reasons, if adverse tax consequences do not result. Section 501(c) contains a menu of exemptions in addition to the exemption available under subsection (3): subsections (c)(2) and (c)(25) create an exempt vehicle for title holding entities (of which (c)(25) is vastly preferable); (c)(4) and (c)(6) entities can be used for various local undertakings; a separate (c)(3) can sometimes be useful for administrative purposes or to segregate a particular charitable activity. Supporting organizations under §509(a)(3) (discussed more fully in Part II below) are versatile as well.

In addition to obvious state and federal tax advantages, exempt entities may entitle directors to additional protections. (See Sec. 6 above.) However, in some states, directors of charitable organizations may also held to higher fiduciary standards of conduct than directors of stock enterprises. (See Sec. 6 above.) The principal drawback of exempt entities is that the exemption process is time consuming and managing exempt affiliates can create traps for the unwary (mostly related to UBIT and private benefit and inurement) for managers unfamiliar with the constraints governing exempts. The exemption requirement and some of the exempt constraints may be avoided without loss of favorable tax treatment through the use and LLC if circumstances permit.

b. Partnerships. The IRS looks favorably upon the participation by universities as limited partners in limited partnerships formed for investments (being about the only activity for which this business format is suitable). A university (and most others these days) will generally avoid participation in general partnerships because each participant is subject to joint, several and unlimited liability for the venture’s debts.

An exempt organization is prohibited from conferring a private benefit upon the other partners by subjecting itself to liability as a general partner unless the so-called Plumstead test is satisfied. In Plumstead Theatre Society, Inc. v. Commissioner, 74 T.C. 1324 (1980), aff’d 675 F.2d 244 (9th Cir. 1982), the Tax Court overturned a prior per se prohibition against participation by an exempt entity in a general partnership.

The following year the IRS issued a two-part test for such participation: (a) the partnership’s activity must not conflict with the exempt organization’s exempt purpose,
and, (b) the exempt organization’s role as general partner must be insulated from certain liabilities so that its role as general partner does not conflict with its exempt mission and does not confer a private benefit on any taxable partners. 39 Joint ventures between taxable and non-taxable entities raise the most complicated tax and governance issues of all affiliates, but a meaningful discussion of those issues is beyond the scope of this outline. 40

c. Limited Liability Company Affiliates. Limited liability companies (“LLCs”) with more than one member that have not affirmatively elected to be treated as corporations are classified as partnerships by the IRS, which will apply the Plumstead principles to analyze whether the exempt organization’s role more closely resembles that of a limited or general partner and the two-part test of IRS Gen. Couns. Mem. No. 39005 to determine whether the LLC’s activities comport with the exempt organization’s charitable purposes.

In the past, the Service was reluctant to recognize single-member LLCs where the single member is an exempt organization as a pass-through entity for tax purposes. 41 After a long delay in responding to several requests for private letter rulings on such entities, the IRS indicated that it would not issue any letter rulings as to whether such entities can be disregarded for tax purposes. 42 Then, in a surprisingly oblique fashion, the IRS seemed to acquiesce to such entities by issuing a directive requiring exempt organizations to report income on their returns from “any wholly-owned disregarded entity.” 43 This announcement was so ambiguous, and seemingly contrary to the earlier IRS position, that one taxpayer asked for confirmation of its import. The IRS response clarified that single member limited liability companies would be treated as disregarded or pass through entities without filing for a separate exemption. 44

Finally, in 2012, the IRS formally clarified its position with regard to the use of single-member LLCs by exempt organizations by issuing IRS Notice 2012-52, 2012-35 I.R.B. 317, which provided that contributions to a single-member LLCs wholly owned and controlled by exempt organizations are eligible for a charitable contribution deduction under IRC § 170(c)(2). Subsequent revisions to the instructions to IRS Form 1023 confirmed the conclusion of many practitioners that a LLC wholly owned and controlled by an exempt entity may also apply for an obtain its own tax exemption under IRC § 501(c)(3).

41 See generally Richard A. McCray & Ward L. Thomas, Limited Liability Companies as Exempt Organizations - Update, 2001 IRS EXEMPT ORG. CONTINUING PROF'L EDUC. TECHNICAL INSTRUCTION PROGRAM 27.
44 Letter from Marvin Friedlander to Catherine E. Livingston (Oct, 27, 1999), in 1999 TAX NOTES TODAY 212-16.
9. What Qualifies as a “Subsidiary” or “Affiliate”?

One of the most challenging issues in this area is the definition of what constitutes an affiliated organization. A particular organization may qualify as an affiliate for some purposes but not others. When an entity is formed for a special purpose by the university’s counsel and all of the officers and many, if not all, of the directors are also employees of the university, it obviously qualifies as an affiliate. But where an entity is initially formed and maintained by the university’s counsel or one of its officers, but the entity moves away from the university’s scope, either through neglect, the excessive zeal for independence, or the evolving nature of its activities, concerns can arise as to whether the university may be liable in a court of law, or the sometimes harsher court of public opinion, for the acts of the affiliate.

One mechanism for dealing with runaway affiliates is to have sufficient controls in place, through which the university infuses capital, permits use of its space and/or its trademarks, and otherwise supplies support, such that it will have a practical means to encourage better behavior at the affiliate level. The difficulty inherent in affiliates, however, is that they are designed to be independent and therefore problems in these organizations are likely to come to the university’s attention long after they have begun. Therefore, university-sponsored start-ups should be utilized only for compelling reasons, such as protecting the parent’s exemption, and mechanisms for oversight, such as routine audits (preferably by third parties) and regular self-reporting should be implemented.

Another category of entities are affiliated only in the sense that university personnel, often high ranking officers, serve on their boards, more or less formally ex officio. For example, the university employee may serve on a community development board, or perhaps solely, by virtue of their affiliation with the university. In these cases, there should be care taken that the university does not become liable, or even perceived as potentially liable, for the acts of the employee as a director of the outside organization.

Care should also be taken that the employee is not unduly exposed to personal liability by performing a public or charitable service on behalf of the university. Of course not all instances of outside board service, whether in a community position or on the board of an entrepreneurial entity established to commercialize university-based research, are for the benefit of the university. It may be helpful to establish some informal guidelines for when such service will be viewed as in the university’s interests, and when it is not, with special care that the service not be characterized in any instance as being in a representative capacity, i.e., as if the institution itself were the board member acting through the agency of the employee.

As internal and external pressures drive universities to enter into areas outside those directly related to their traditional, educational missions, the use of affiliates will probably increase. As university affiliates grow in net worth and engage in activities, such as the commercialization of new technologies, creditors, the government and potential claimants, such as plaintiffs in product liability suits, will test the envelope of these entities. The manner in which these entities are formed and maintained, and how the university articulates its relationship to such entities, will largely determine whether or not affiliates are successful in meeting their overall objectives. In many cases, it will make more sense to address these issues...
with an implicit rather than through an explicit policy, to avoid creation of a road map to those who might seek to disregard the subsidiary’s separate existence.

10. **Key Elements of a Policy on Subsidiaries and Affiliates**

Either through drafting documents for new entities or by conducting a due diligence review of the documents governing more distinct entities, the following should be checked:

- Ascertain that the entity will be respected for state law (entity) and federal law (tax) purposes;
- Verify that the affiliate has adequate capitalization and insurance to cover its obligations;
- Develop and use separate letterhead, invoices and checks;
- Maintain separate bank accounts and do not commingle assets;
- Document intercompany transfers of assets at market value;
- Pay the salaries of any employees out of the entities own funds and allocate fairly and reasonably any overhead for shared office space or shared employees;
- Establish clear guidelines for the entity’s permissible range of activities to minimize urge for impermissible day-to-day involvement;
- Avoid day-to-day operational involvement in the affiliate;
- Observe “corporate” formalities applicable to entity (keep minutes, make state law filings, hold annual meetings, keep separate books and records);
- Maintain segregated books and records for the entity;
- Help directors and officers understand their fiduciary duties and the best methods to resolve conflicting duties;
- Where appropriate, encourage use of outside directors;
- Provide “reasonable” compensation, if any, for subsidiary directors and officers, and sensitize management to private inurement and private benefit concerns;
- Encourage adoption and use of an adequate conflicts of interest policy;
- Obtain maximum protection for directors through director/officer insurance, adoption of most liberal standard for director indemnification under relevant state law;
- Provide for periodic financial and legal audits of entity by third party professionals, and retention of separate counsel where ethically required; and
- Safeguard use of the university’s name by affiliates through licensing agreements.

**PART II: THE USE OF AFFILIATES IN CROSS-BORDER ACTIVITIES**

1. **Domestic Universities Conducting Activities Abroad**

Recent years have seen rapid expansion in the international involvement of domestic universities beyond their traditional participation in foreign exchange and study abroad programs. In addition to these activities, many universities are now establishing independent satellite campuses abroad, developing research laboratories and commercial ventures with foreign institutions and entering into partnerships with foreign universities to provide joint educational instruction. Problems may arise, however, when a university expands rapidly abroad without first
considering the associated myriad of tax and other legal implications in both the US and the host country.

a. Operating through a Foreign Branch Office. Tendencies toward simplicity may favor foreign activities conducted by the university itself, operating through a foreign branch office rather than through a special purpose entity. A foreign branch office will often be simpler to operate and less expensive due to the potential for reduced filing and accounting costs, although host jurisdictions may require the university to register as a foreign entity doing business in the host country. Such registration requirements may also give rise to periodic local filing obligations. A facts-and-circumstances analysis of the university's activities during the year will likely be required to determine whether such filings are necessary. In most cases, a university would be wise to seek local counsel to assist in the analysis of host country legal issues.

It is important to remember that although a university is exempt from tax under US law, it may not necessarily enjoy similar status abroad. Consideration should be given to whether the host country has entered into a bilateral income tax treaty with the United States. While a full analysis of treaty issues relevant to US universities abroad is beyond the scope of this outline, most bilateral income tax treaties provide a "permanent establishment" test that defines the scope and type of activity required to create taxing nexus in the host jurisdiction. If the university's activities in the host country are substantial enough to subject it to the host country's income tax, advice should be taken regarding the availability of tax exemptions under local law.

As most jurisdictions do not impose a separate withholding tax on branch profits remitted back to the United States, assets can generally flow free of tax and administrative complication between the university and its foreign branch. Moreover, in certain jurisdictions, foreign branches may avoid "local control" requirements imposed on local entities with foreign shareholders or members. These benefits should be balanced with the potential for a foreign branch to subject the university to court jurisdiction in the host country and the possibility that the university's assets could be subject to the claims of creditors of the foreign branch. In all cases, care should be taken to ensure a foreign branch complies fully with US law. Among other things, this means avoiding private inurement and excess benefit transactions and otherwise taking all necessary steps to protect the university's tax exempt status.

b. Establishing a Host Country Affiliate. A more prudent approach in light of the jurisdictional and liability issues associated with the operation of a foreign branch office may be the establishment of a separate, wholly-owned or controlled legal entity formed in

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45 A university can generally conduct operations abroad without jeopardizing its tax-exempt status. See IRS Rev. Rul. 71-460, 1971-2 C.B. 231 (domestic charity qualified for exemption under IRC § 501(c)(3) even though it carried on significant activities abroad).
46 For a more thorough explanation of the application of "permanent establishment" tests to colleges and universities, see BERTRAND M. HARDING, JR., THE TAX LAW OF COLLEGES AND UNIVERSITIES (3rd ed. 2007).
47 For example, because of strong public policy in the US against racial discrimination, a university's operation of a school abroad must meet US standards for non-discrimination, even if compliance with such standards is not customary in the host country. IRS Rev. Proc. 75-50, 1975-2 C.B. 587.
the host country. The appropriate choice of entity should be determined in consultation with local counsel, but likely choices would be (i) a limited liability company equivalent (like a société à responsabilité in many European countries); (ii) a stock or non-stock corporate equivalent (like a société anonyme in many European countries); or (iii) a designated foreign nonprofit entity (like the French association loi 1901).

The members or shareholders of such affiliated entities generally enjoy limited liability, providing a level of protection for the university. Moreover, the use of such an entity may limit the scope of disclosures and filings made with the host country government, whereas the operation of a branch office will likely subject the university to more expansive reporting requirements. Lastly, host country entities are in some instances more likely to obtain a local tax exemption, a process that may be administratively complicated (if possible at all) for the university itself.

In selecting a foreign entity, consideration should be given to whether the entity will be regarded or disregarded for US tax purposes under the “check-the-box” rules promulgated under IRC § 7701. For eligible foreign entities with a single owner enjoying limited liability, the check-the-box rules provide a default classification as an association taxed as a corporation. If the default classification is not desired, an affirmative election will need to be made within 75 days of the affiliate’s formation. To the extent possible, the organizational test of IRC § 501(c)(3) should be followed in establishing the foreign affiliate so that it is independently eligible for tax-exempt status under US law.

c. Supporting Organizations. If a university wishes to further distance its assets from foreign operations and their attendant regulatory constraints, a separate supporting organization may be established either to carry out foreign operations directly, or to own and finance a foreign affiliate. Supporting organizations are separate nonprofits that exist to support another exempt organization.48 To qualify as a supporting organization, an entity must be organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of another charitable organization and must fit into one of the following three categories:

i. “Type I” Supporting Organizations. Type I supporting organizations must be “operated, supervised or controlled by” one or more charitable organizations. This relationship is generally in the nature of a parent-subsidiary relationship, in which the supported organization exercises a substantial degree of direction over the conduct of the supporting organization.49 This arrangement is most commonly established by having a majority of the officers, directors or trustees of the supporting organization selected by representatives of the supported organization.

ii. “Type II” Supporting Organizations. Type II supporting organizations are those “supervised or controlled in connection with” one or more charitable organizations. This relationship is generally in the nature of a brother-sister

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48 IRC § 509(a)(2).
49 IRC § 509(a)(3)(B)(i); Treas. Reg. § 1.509(a)-4(g)(1).
relationship, in which the persons supervising or controlling the supporting organization also supervise or control the supporting organization.\textsuperscript{50}

iii. “Type III” Supporting Organizations. Type III supporting organizations are those “operated in connection with” one or more charitable organizations. This complex relationship requires the supporting organization to satisfy a notice requirement, a responsiveness test and an integral part test.\textsuperscript{51} Various provisions enacted by the Pension Protection Act of 2006, including a prohibition on Type III supporting organizations supporting foreign charitable organizations, have made their use much less appealing.\textsuperscript{52}

For present purposes, the supported organization could either be the university itself (a necessity if the supporting organization were to operate abroad directly), or a separate foreign charitable entity.\textsuperscript{53} Importantly, both Type I and Type II supporting organizations cannot have purposes broader than those of their supported organization. While the supporting organization paradigm typically places the supporting organization in an ancillary role, it is permissible for the supporting organization to serve as a parent organization for a supported foreign charitable affiliate.\textsuperscript{54}

d. Foreign Entities Formed to Raise Funds for US Universities. US universities interested in fundraising abroad may wish to establish a foreign fundraising affiliate. While requirements vary widely across jurisdictions, the ability to solicit tax-deductible contributions abroad is typically linked to the concept of public benefit (i.e. ensuring that donated funds will serve a broad class of people). In some countries, the form of legal entity selected may determine its tax status and a separate exemption procedure may need to be followed so that the affiliate is recognized as exempt in both the host jurisdiction and the US. For example, the Mexican government requires an additional administrative registration for organizations seeking recognition of exemption for both Mexican and US purposes. Although these requirements may seem burdensome at first blush, recent rulings from European courts have gestured toward multi-jurisdictional tax relief for gifts to exempt entities formed in EU or EEA member countries.

e. US Regulatory Compliance. Universities conducting activities abroad should be mindful of their US regulatory obligations, including the impact of the sanctions programs administered by the US Treasury Department's Office of Foreign Assets Control (“OFAC”). OFAC operates a country-based sanctions program that restricts US universities from engaging with specific countries or governments and may require a university to obtain a license before conducting an activity abroad. OFAC regulations also

\begin{itemize}
\item \textsuperscript{50} IRC § 509(a)(3)(B)(ii); Treas. Reg. § 1.509(a)-4(h).
\item \textsuperscript{51} IRC § 509(a)(3)(B)(iii); Treas. Reg. § 1.509(a)-4(i). Compliance with these tests has been described by the judiciary as “fantastically intricate and detailed.” Windsor Found. v. United States, 77-2 U.S.T.C. 9709 (E.D. Va. 1977).
\item \textsuperscript{52} IRC § 509(f)(1)(B)(i).
\item \textsuperscript{53} In IRS Rev. Rul. 74-229, 1974-1 C.B. 142, the IRS determined that an organization can qualify as a supporting organization if it supports an organization that meets the requirements of IRC § 509(a)(1) or (2), even if that organization is a foreign organization.
\item \textsuperscript{54} See IRS Priv. Ltr. Rul. 9503021 (Jan. 20, 1995), 9343024 (Jul. 29, 1993), 200044039 (Nov. 6, 2000).
\end{itemize}
prohibit transactions with specific individuals or organizations (“Specially Designated Nationals”). OFAC publishes an annual list of Specially Designated Nationals on its website which should be consulted by the management of a foreign branch before entering into transactions abroad. Failure to comply with OFAC restrictions can result in civil fines or, if violations are intentional, criminal penalties.55

2. Foreign Universities Expanding into the United States

a. Fundraising in the United States – “Friends” Organizations. Although funds raised by a US university can be used outside the United States, contributions made directly to a foreign university are generally not deductible for US income tax purposes. For this reason, many non-US organizations create US fundraising affiliates (“Friends Organizations”) to provide a US tax benefit to donors. Since US tax law provides favorable treatment for donations to organizations that qualify as public charities, Friends Organizations of foreign universities are sometimes structured as Type I or Type II supporting organizations (discussed above), which are not required to satisfy a public support test to maintain their status as public charities.

The IRS regularly permits the deductibility of contributions to Friends Organizations provided that the Friends Organization does not act as a “mere conduit” of funds to foreign organizations. This generally means that the governing body of the Friends Organization must retain independent control and discretion to make (or not make) grants to its non-US affiliate. The organizational documents of the Friends Organization should clearly define the power of its governing body to retain control and discretion over donated funds and the power to make grants to any organization operated for exempt purposes. The Friends Organization should also refuse to accept contributions that are earmarked by donors for a specific non-US organization or purpose, unless those goals have been previously approved and adopted by the Friends Organization's governing body.

An IRS Revenue Ruling approving the deductibility of contributions to a Friends Organization provides a useful roadmap for crafting the Friends Organization's governing documents, noting that acceptable bylaws provided that:

“(1) the making of grants and contributions and otherwise rendering financial assistance for the purposes expressed in the charter of the organization shall be within the exclusive power of the board of directors; (2) in furtherance of the organization's purposes, the board of directors shall have power to make grants

55 Additional anti-terrorism limitations must also be complied with to avoid civil and criminal liability. In response to 9/11, Exec. Order No. 13224, 66 Fed. Reg. 44,079 (Sep. 25, 2001), and provisions of the USA Patriot Act of 2001, P.L. 107-56 (Oct. 26, 2001), each of which establish civil and criminal liability (often without an intent or knowledge requirement) for organizations that enter into transactions with individuals associated with terrorism. After numerous requests for guidance, the US Department of the Treasury released its Anti-Terrorist Financing Guidelines: Voluntary Best Practices for US-Based Charities (2006), available at http://www.treas.gov/press/releases/reports/0929%20final revised.pdf. These sources merely scratch the surface of the substantial body of law that has developed with respect to the anti-money laundering and anti-terrorism efforts relevant to US charitable organizations. For a more thorough discussion of the application of these rules, see HOPKINS, supra note 39, at § 28.19.
to any organization organized and operated exclusively for charitable, scientific or educational purposes within the meaning of Section 501(c)(3) of the Code; (3) the board of directors shall review all requests for funds from other organizations, shall require that such requests specify the use to which the funds will be put and if the board of directors approves the request, shall authorize payments of such funds to the approved grantee; (4) the board of directors shall require that the grantee furnish a periodic accounting to show that the funds were expended for the purposes which were approved by the board of directors; and (5) the board of directors may, in its absolute discretion, refuse to make any grants or contributions or otherwise render financial assistance to or for any or all the purposes for which funds are requested.

The bylaws also provide that after the board of directors has approve a grant to another organization for a specific project or purpose, the corporation may solicit funds for the grant to the specifically approved project or purpose of the other organization.

A tension seems to exist between the independence required to avoid characterization of the Friends Organization as a “mere conduit” and the control mechanisms required to establish eligibility as a Type I or Type II supporting organization. Nevertheless, the IRS has issued private letter rulings approving the deductibility of contributions to Friends Organizations structured as supporting organizations. Foreign universities interested in structuring Friends Organizations as Type I or Type II supporting organizations should work with counsel to establish an appropriate balance between the required control mechanisms and the independence required to avoid characterization as a “mere conduit.”

b. Establishing a US Affiliate. Foreign universities interested in expanding active operations into the United States face first-level decisions similar to those confronted by US universities operating abroad. In the first instance, the foreign university must decide whether to conduct its operations through a US branch office or through a separate US affiliate organization. As with their domestic counterparts, these decisions will largely be driven by the foreign university's relative sensitivity to tax, regulatory and liability concerns. If the US branch alternative is selected, the foreign university will want to apply for tax-exempt status in the United States, but should do this with the understanding that obtaining this status will not allow it to receive tax deductible contributions from US donors and that, while the foreign university will be exempt from income tax, it will still be subject to employment, withholding and other domestic tax regimes. The foreign university should also be prepared for the broad regulatory disclosures required by US exempt organizations.

If greater control and compartmentalization is desired, a separate US organization can be formed and can obtain an independent 501(c)(3) charitable designation. The

58 IRC § 170(c).
precise form that the US entity will take depends largely on the precise activities to be undertaken, with a bias toward crafting a US entity that will qualify as a public charity. If the activities are in the nature of educational instruction, medical research or other variants eligible for per se public charity classification, greater flexibility is permitted. For other activities, a Type I or Type II supporting organization may be preferable to avoid regular monitoring of the US organization's public support. In all events, the primary benefits of a separate US affiliate will be similar – limiting the foreign university's exposure to liability from US operations, controlling the nature and extent of US tax and reporting disclosure and providing a certain degree of operational autonomy.

CONCLUSION

Affiliated organizations can serve many useful purposes for US and foreign universities. The key to the successful use of such entities is thoughtful and clear delineation of goals from the outset, appropriate tax planning and effective management. As university activities become more innovative, entrepreneurial and international, management needs, tax efficiency, liability concerns and other considerations increasingly favor housing such activities in more sophisticated interorganizational structures. The efficacy and success of these structures will often turn on a university's ability to supervise the role and function of each affiliated entity as it grows and develops.

The prudent selection of directors and managers, and continuous monitoring of the activities of such organizations is paramount in this regard. It is critical that such entities be maintained, that they document their activities so that the corporate or company form is respected, and that the university does not succeed to the liabilities that the affiliated is intended to ring fence. Likewise, these organizations need directors and managers who can understand and observe the niceties of acting independently but always in the best interests of the parent university.

The need to strike this balance is pervasive. When the organizations strays from its intended purpose, it is important that a vigilant university is poised to move quickly and effectively to discipline or, if necessary, abandon its wayward offspring. As the regulatory landscape continues to evolve, and as the tax laws are amended and supplemented, it is important to have capable counsel review the activities of the organization to optimize its effectiveness.
The Cooperative Organizations of Georgia Institute of Technology

Cooperative Organizations

University System of Georgia

Georgia Institute of Technology

Georgia Advanced Technology Ventures, Inc.

GT Real Estate Services, LLC (facilitates the purchase and transfer of real estate to the Institute)

GT Innovation Fund, LLC (provides seed funding for startup companies)

VLP 2, LLC (Real Estate)

TEP 1, LLC (Real Estate)

VLP 3, LLC (Real Estate)

VLP 4, LLC (Real Estate)

Georgia Tech Athletic Association

EmTech, Inc.

Global Center for Medical Innovation, Inc.

Global Center Lafayette (France) (GT Lorraine is also a member of this entity)

Georgia Tech Facilities, Inc.

GT Real Estate Services, LLC (facilitates the purchase and transfer of real estate to the Institute)

Georgia Tech Alumni Association

Home Park Learning Center, Inc.

Georgia Tech Foundation, Inc.

Georgia Tech Research Corporation

EmTech, Inc.

GT Innovation Fund, LLC (provides seed funding for startup companies)

Georgia Tech Applied Research Corporation

Southern Light Rail, Inc.

TEP 2, LLC (Real Estate)

VLP 2, LLC (Real Estate)

Georgia Tech Athletic Association

TEP 1, LLC (Real Estate)

VLP 3, LLC (Real Estate)

VLP 4, LLC (Real Estate)

Georgia Tech Costa Rica Foundation (Agreement pending)

EmTech, Inc.

Southern Light Rail, Inc.

Georgia Tech Panama Foundation

Georgia Tech Costa Rica Limited

Institute Lafayette (France)

*In transition – corporate entity to be terminated in 2016/2017

*In transition – corporate entity to be terminated in 2016/2017
AGB Draft Statement on Institution-Foundation Relationships
3/28/2016

Please share your comments on this draft by email to David Bass, AGB director of foundation programs at DBass@agb.org.

Preface

The business models of many public college and universities are in transition. State funding has been declining as a percentage of institutions’ budgets. Institutions have closed the gap by raising tuition and, wherever possible, cutting costs, but concerns about accessibility and student debt limit more fee increases. At some large research universities with mature development programs, private resources already surpass state support as a share of operating budgets. With larger endowments institutions have begun to rely more on affiliated foundations as private partners to support real estate projects and other entrepreneurial ventures. Institution boards must also ensure that appropriate risk management and oversight functions are in place. AGB’s 2014 Report of the National Commission on College and University Board Governance recommended that “boards need to place greater attention... [to] improved oversight of auxiliary and affiliated organizations.”

Institutionally related foundations have played a vital role in raising and managing private support for student financial aid, faculty chairs, academic programs, athletics, and facilities. Foundation boards represent the most committed and generous donors to public colleges and universities. These compelling advocates have been invaluable sources of guidance and counsel to both foundation and institution leadership. As public institutions look to foundations to build fundraising capacity, tensions between institution presidents and boards and the chief executives and staff of affiliated foundations may be growing as well.
This AGB board statement addresses governing boards and senior administrators of public college, university, and system foundations. While public institutions may have many affiliated entities (foundations, corporations, auxiliaries, associations, clubs, etc.) performing a range of functions, this statement is intended to apply to foundations, typically 501(C)(3) publicly supported charities, that serve as gift repositories, invest and manage endowment funds, may perform fundraising functions, and provide other services and support to their affiliated institutions. The principles and recommended practices outlined in this statement are intended to help boards and administrators foster close collaborative partnerships to advance the missions and strategic priorities of their institutions. Readers will need to take state statutes, case law, system policy, and specific institutional contexts into account as they consider and apply the following recommendations.

**Task Force on Institution-Foundation Relationship**

This statement was develop with the guidance and support of a specially convened task force including:

- William E. (Brit) Kirwan, Chancellor Emeritus, University System of Maryland (chair)
- David Bass, Director Foundation Programs, AGB (staff)
- John Casteen, President Emeritus, University of Virginia
- Sue Cunningham, President, CASE
- Fred DuVal, Former Chair, Arizona Board of Regents
- Mike Goodwin, President and CEO, Oregon State University Foundation
- James Lanier, Senior Fellow and Consultant, AGB
- Lynette Marshall, President and CEO, University of Iowa Foundation
- Karen Meyer, Board Member, UVM Foundation, and member University of Vermont Board of Directors
- Martin Michaelson, Partner, Hogan Lovells
- Charles Reed, Chancellor Emeritus, California State University
- John Walda, President, NACUBO
Current Contexts

Increasing Importance of Effective Institution-Foundation Partnerships

In recent years, the business model of public higher education has been changing. State support for public higher education has, with ups and downs, been declining since 1980. Institutions have filled the gap by increasing tuition and cutting budgets, but concerns about rising student debt and questions about the return on students’ investments in their degrees have led to widespread criticism and, in some cases, legislative caps on tuition.

Public college and university leaders are envisioning institutions that continue to fulfill public purposes with increasingly privatized business models. While state funding for public colleges and universities has dwindled over the past 35 years, private support has consistently grown as a result of an increased focus on and investment in institutional advancement. In 2015 public institutions received $19.7 billion in voluntary support (VSE 2015) and endowment distributions funded 6.1 percent of public institutions’ operating budgets (NCSE 2015). Voluntary support will not fill the gap created by declines in state support in the foreseeable future. But at institutions with mature development programs the “margin of excellence” funded by private resources has outstripped the proportion of operating budget funded by the state. Private resources conferred crucial competitive advantages in the form of scholarships, endowed chairs, and transformative programs and infrastructure. For institutions of all stripes, private support is becoming increasingly central to their financial sustainability.

States are also decreasing funding available for capital projects, leading institutions to turn to their foundations for assistance with acquisition, development, and management of real estate and other revenue-generating projects. The imperative to raise private funds and manage resources prudently has never been greater, and public colleges, universities, and systems are looking to foundations to help accomplish those goals.
Changes in Development and Advancement Models

As fundraising has moved from the margin to the center of presidential agendas, relationships between institutions and their affiliated foundations have been changing as well. AGB research suggests that institutions both large and small are evaluating their advancement structures and, in some cases, transferring responsibility for development functions from campus to foundation or vice versa. Other institutions are aligning fundraising, alumni programs, and communications as part of more centralized advancement models in which foundation, institution, and other affiliated entities are more closely integrated. When changes are made, foundations may assume increased responsibility and authority for development functions or cede some responsibilities to institutional oversight. In addition to changes in oversight or management responsibilities, campus leaders are asking foundation boards to provide more engaged and active volunteer leadership for fundraising and to undertake increasingly ambitious campaigns. AGB’s research, our consulting work and engagement with members all suggest that institution leaders and foundation boards are working to better align strategy and priorities, to increase volunteer engagement in fundraising, and to foster more effective partnerships.

Transparency, Public Trust, and Foundation Independence

Public perceptions of institutional inefficiency or extravagance (well-founded or not), concerns about undue donor influence, and a growing focus on enterprise risk management have created a climate in which foundations are subject to heightened expectations of accountability and transparency. The use of private funds to renovate or acquire presidential residences, build athletic facilities, provide compensation supplements for senior administrators, or bring controversial speakers or faculty to campus, can all advance important institutional purposes but may also spark scrutiny by media and legislators and protests by students, alumni, and other stakeholders. Such “scandals,” for which social media coverage confers greater frequency and velocity, entail a genuine waste of resources and erode faith in the integrity of public institutions.
In California, a foundation’s payment of a speaking fee to a high-profile politician was among the factors driving passage of legislation that extended Freedom of Information Act provisions to foundation records. Concerns about foundation expenditures have advanced similar legislation in Connecticut and Illinois. In other states concerns about foundation expenditures of unrestricted funds for presidential residences, travel, compensation, and other purposes have led to state investigations, changes in system policy regarding foundation controls and oversight, and costly and corrosive criticism in traditional and social media. Endowment spending rates are also under close watch. The Senate Finance and House Ways and Means Committees, assuming that institutions could more effectively tap endowments to offset student costs, recently sent a letter to institutions and foundations with large endowments asking for detailed information on spending rates, endowment management fees, and student financial aid. Independent of congressional action, public questions about the use of foundation funds and the public benefits associated with charitable giving incentives and tax exemptions will continue. Public institutions and foundations need to demonstrate wise stewardship of funds and the contribution of private support to the public good.

Whether a foundation’s status as a private corporation exempts it from state freedom of information laws varies from state to state and institution to institution, based on state statutes, case law, and system policies. AGB has argued that foundations’ ability to demonstrate financial and operational independence could serve as a defense against claims that they should be subject to state freedom of information laws. Analysis of court rulings on the applicability of open records laws to foundations suggested that courts looked to various facts and circumstances demonstrating independence when determining whether foundations should be subject to state freedom of information laws and other provisions applicable to state entities.

An Iowa Supreme Court ruling of 2005 took a different approach that may serve as a model for courts in other states. While acknowledging that a university foundation effectively operated as an independent non-state entity, it nonetheless opened the foundation’s records, arguing that the foundation, in its capacity as the university’s fundraiser, fulfilled a fundamental institution responsibility and that open records
requirements could not be skirted by delegating functions to an independent agent. In effect, Iowa’s open records requirements were applied to university functions rather the corporate entity that performed them. In March of 2015, a judge in DuPage County, Illinois, articulated a very similar argument in a decision extending open records requirements to an institutionally related foundation.

While it may still be important for some foundations to maintain genuine financial and operational independence, such a goal is not, realistically, within the reach of most foundations that provide significant development services and employ their own staff. Changed expectations regarding transparency have also made invocation of foundation “privacy” more problematic. External observers often fail to distinguish between a college or university and its related foundation. While a foundation may be a private corporate entity, steadfast defenses of organizational privacy can fuel suspicions of wrongdoing and perceptions of secrecy, undermining the trust essential to effective fundraising and advocacy.

There are compelling arguments that foundations should be able to safeguard critical information they collect for fundraising purposes and in connection with entrepreneurial ventures and investments. Most importantly, they need to provide prospects and donors with the assurance that personal information shared with the foundation will be protected. While some courts and legislatures have carved out exceptions to disclosure requirements for donors who have specifically requested anonymity, such protections are limited and may lead to serious compromises of donor privacy. In such circumstances donors concerned about privacy are more likely to give through private foundations or deploy other means to conceal their philanthropy. The impact of anonymous gifts as examples and incentives for other donors is decreased. Genuinely anonymous giving deprives institutions of the opportunity to collaborate with prospects to align philanthropic and institutional objectives. Beyond safeguarding donor privacy, foundations’ operational and financial independence may lessen other regulatory and compliance burdens, such as state prevailing wage or contracting requirements, which undermine their ability to be nimble entrepreneurial partners to their institutions.
This climate challenges institutions and foundations to strike a delicate balance. The public demands assurances that foundations aren’t just a means to conceal donor influence, confer private benefit, or violate the spirit of open government and charitable purpose. Foundations must guard donor and prospect privacy to fulfill functions that would be impossible, impractical, or inefficient for state entities.

When making policies about disclosure of foundation information and responding to requests for information from the institution, the media, or members of the public, foundations should look beyond minimum disclosure requirements, affirming a culture of accountability and transparency that closely matches that expected of their campus partners. A thoughtful analysis of state law, institutional contexts, and current data privacy practices will help foundations develop policies on the voluntary disclosure of different types of information.

Foundations in a few states are also subject to open meeting requirements. Foundations usually have the ability to engage volunteers in candid discussion about the interests, relationships, and philanthropic capacity of prospective donors or board members. Foundation boards may need to discuss proprietary information provided by investment firms and keep confidential information relating to business transactions such as the acquisition or sale of real estate. Perhaps most fundamentally, boards benefit from the ability to assess and discuss their own performance and the performance of employees for whom they are responsible without fear that it will be a matter of public record. Proactively working with campus leaders, other constituents, and members of the news media in ways that are as transparent and forthcoming as possible without compromising donor privacy or the foundation’s ability to fulfill its mission is the best safeguard against potentially burdensome and counter-productive open-meeting mandates.

The Risk Management Imperative

Foundations can strengthen risk management as independent stewards of private resources, honoring donor intent, and prudently and effectively managing assets. As private non-profit corporations, foundations can operate far more nimbly and provide numerous tactical benefits. Foundation boards bring valuable private sector expertise and
can typically devote more time and attention to oversight of complex business ventures than can institution governing boards. Foundations may also, however, be sources of risk. The growth of foundations’ endowments, real estate holdings, data, and other resources increase the financial risk associated with foundations for their partner institutions. Divisions of responsibility among campus administrators and staff of affiliated entities may create gaps in governing board oversight and enterprise risk management. This issue is particularly challenging for system boards that need to respect the autonomy of campus administrators while monitoring and managing financial, reputational, or compliance risk associated with foundation activities and assets.

AGB’s 2014 National Commission on College and University Board Governance underscored these concerns, singling out oversight of affiliated organizations as an area where institution boards should be placing greater attention. First and foremost, boards should ensure that comprehensive policies and business practices are in place and implement internal controls and audit practices to verify that they are consistently followed. Second, institution and foundation boards should work together to align and integrate enterprise risk management processes to ensure that risks stemming from foundation activities are understood by the institution board and that the foundation board and administration are apprised of institutional risk factors that could adversely affect the foundation. AGB’s publications on Enterprise Risk Management and Understanding Foundation Finances provide valuable overviews of questions both institution and foundation boards should ask about the comprehensiveness of their risk management and foundation-related policies. AGB Consulting and the AGB Foundation Leadership Forum also provide resources and support on these issues.

Finally, in the event of scandals, real or imagined, the conduct of individuals, institutions, and affiliated entities are likely to be blended and confused. Social media accelerates public relations crises. Close coordination of response and messaging among all individuals and entities perceived as representatives of an institution is vital. Foundation board members have great credibility. They are typically well-respected community and business leaders with no direct professional or financial interests in the institution who have demonstrated their confidence in the institution though significant
philanthropic support. Institutions should look to foundation boards not only as fundraisers and stewards of private assets but as potent allies and advocates in external relations.

**Changing Dynamics and the Potential for Tensions in the Institution-Foundation Relationship and the Foundation Board Room**

Reassessment of long-standing relationships and the prospect, or reality, of change always poses challenges for administrators and boards. AGB is seeing clear evidence that tensions, and in some cases, conflicts about the roles of foundations, the authority and responsibilities of foundation boards, and governance and management practices are becoming more common. Financial pressures are prompting presidents, deans, and other campus and system administrators to take a greater interest in foundation functions that may have been the sole purview of foundation boards or staff. Presidents, challenged to do more and more with less and less, increasingly look to foundations to help generate the funds to advance their strategic visions. In some cases, they may feel the need for more direct control over functions historically overseen by foundation boards, including allocation of resources, staffing decisions, and fundraising operations. This may be perceived as encroachment upon the historic independence of a foundation.

Long-serving foundation board members, recruited when expectations about giving and fundraising responsibilities were different, may be discomfited by changes and feel that past contributions are less valued. Volunteers’ expectations for board service are also changing. No longer content with honorific roles, newer generations of board members are challenging institution leaders to engage them in meaningful strategic capacities. They may advocate for changes in governance practice opposed by long-tenured board members. When institution and foundation visions and strategies are poorly aligned, miscommunicated, or otherwise thwarted by institution or foundation culture, politics, or practices, the institution-foundation relationship can become fraught with tension, friction, and frustration. When intuition leaders meaningfully engage foundation boards, collaborating to develop shared visions, enhanced advancement models, thoughtful and
ambitious campaign plans, and entrepreneurial strategies, the institution-foundation partnership can be a vital driver of institutional progress and excellence.

The following principles and recommendations are intended to guide institution and foundation boards and administrators to develop policies and practices that mitigate risk, foster accountability and collaboration, and forge more effective institution-foundation partnerships.

**Fundamental Principles for Effective Institution-Foundation Partnerships**

I. **Foundations’ Fiduciary Responsibilities**: Foundation boards have fiduciary obligations to the affiliated institution, their donors, and the public at large. Foremost is to ensure that assets are prudently managed, gift funds are spent strictly in accordance with donor intent, and that public trust is maintained at the highest level (see *AGB Board of Directors’ Statement on the Fiduciary Duties of Governing Board Members* and *Effective Foundation Boards*). Foundation boards’ duties of care and loyalty may be construed as extending not only to the interests and mission of the foundation, but to the institution they pledge to support.

II. **Institutional Respect for Foundation Boards**: Institution boards and administrators must respect foundations’ fiduciary obligations and recognize that foundation assets, with very limited exceptions, derive from charitable contributions and should be used in ways that honor philanthropic purposes. Foundation boards are typically comprised of the most committed donors and advocates of the institution with tenures of service that often outstrip campus boards and administrators. Their capacity to provide strategic guidance and insights should be recognized along their financial support and stewardship.

III. **Institutional Determination of Strategic Priorities and Oversight of Campus/System Administration**: Institution boards and/or presidents have ultimate responsibility for setting institutional strategy; determining financial
priorities; identifying fundraising objectives; and hiring, assessing, and setting compensation of institution employees. But they should collaborate closely with foundation staff and boards in decisions concerning the work or operation of the foundation. Meaningful engagement of foundation boards (and other donor and volunteer communities) in strategic planning, identification of philanthropic priorities, and campaign planning is essential to effective institutional advancement.

IV. **Shared Responsibility for Philanthropy:** Philanthropic leadership is a shared responsibility of institution and foundation boards as well as presidents and other senior administrators. Advancement structures vary widely among institutions. At some institutions, development, alumni relations, and communications are overseen directly by central administration. In other cases development functions may be fulfilled primarily or exclusively through foundations and alumni associations. Even in cases where fundraising is the purview of an operationally independent foundation, the institution president and governing board still have a responsibility to support fundraising efforts, ensure adequate and equitable funding models for development, lead through their personal giving, participate in donor identification, cultivation, and stewardship, and help to foster an institutional culture of philanthropy.

V. **A Culture of Collaboration:** Frequent and candid communication among foundation and institution administrators and board members is essential for effective institution-foundation partnerships. The policies and practices recommended throughout this document are all intended to help foster mutual understanding, communication, and accountability. But ultimately a culture of collaboration requires trust. Regular interaction between institution and foundation boards and administrators, both formal and informal, are vital means to build the mutual understanding and personal relationships conducive to trust and collaboration.

VI. **Foundation Transparency:** Foundations’ status as private corporations should not be exploited to shield information about transactions between public institutions and private individuals or corporations. Institutions and foundations should embrace the highest standards of voluntary transparency commensurate with the
protection of donors’ privacy and strategic business interests. Ultimately the preservation of public trust and the best interests of the institution, within the constraints of state law and institutional policy should inform decisions on the information disclosure.

VII. **Foundation Independence:** The degree of financial or operational independence necessary for a foundation to fulfill its mission varies widely from state to state and institution to institution. Where foundations are charged with significant responsibility for executing development or other functions, their boards should be entrusted with commensurate authority. Foundation boards should, in turn, recognize that foundations’ work should always advance the mission, vision, and priorities of the institution as determined by the institution’s governing board and president. Ultimately, foundations’ fiduciary responsibilities and the best interest of the institution should be the determining factors.

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**Shared Responsibility for Fundraising (TEXT BOX)**

Foundations’ responsibility for development functions varies enormously. Some foundations have primary responsibility for funding, staffing, and executing fundraising programs on behalf of the institution. In other cases fundraising staff and operations are the sole purview of institution administrators. Even in cases where a foundation has little or no responsibility for development functions, foundation boards can provide invaluable support for and leadership of fundraising. Board members’ fundraising leadership starts with their personal philanthropy: annual giving, major and campaign gifts, and estate or planned gift commitments. Explicit expectations for all three are common for foundation boards. All too often fundraising is equated with asking for money; a prospect that understandably makes many volunteers uncomfortable. The actual solicitation of gifts is typically the responsibility of development officers, presidents, and senior academic leaders, choreographed by the chief advancement or development officer of the institution or foundation. Beyond personal giving, boards can support fundraising by 1) ensuring that all members of the board make annual and major contributions commensurate with their capacity and agreed-upon expectations 2) helping to identify and vet philanthropic opportunities and fundraising priorities 3) helping to identify prospective donors (individual and corporate) 4) helping to qualify prospective donors by providing
development staff with insights on prospects’ philanthropic capacity, interests, and affinities 5) making introductions and opening doors 6) joining staff in cultivation of prospective donors 7) helping development officers frame proposals and solicitation strategies and participating in solicitation 8) thanking donors 9) providing ongoing stewardship of donors and 10) celebrating the impact of philanthropy.

Delegation of development functions to foundations does not exempt institution boards and administrators from responsibility for fundraising. In cases where the foundation oversees fundraising programs, the foundation and institution should collaborate on the development of annual fundraising objectives and jointly sign off on development goals and plans. Both institution and foundation leaders should review progress towards goals regularly throughout the year. While external benchmarking of fundraising performance poses numerous challenges, the identification of both internal and external benchmarks provide a valuable means of monitoring fundraising performance. Institutions and foundations are jointly responsible for ensuring predictable and sustainable funding models for development. While foundations with large endowments may fund a majority of development staff and operations, they typically rely on various fees for service or other financial or operational support from the institution. Both campus and foundation boards should understand development and campaign funding models and collaborate on budgeting and allocation of resources.

**Recommended Practices**

Note: Institutional structures, foundation functions, system policies, state regulations, case law, and governance models vary widely. The following recommendations may not all be applicable to all institutions and foundations. In cases where a recommendation is deemed impossible or impracticable, boards are encouraged to consider how they may be adapted or to identify alternative practices that fulfill similar functions.

**Determinant of Foundation Functions and Priorities**

1. The mission and purpose of any institutionally related foundation is not determined solely by the foundation board. Its mission and purpose should be determined in partnership with the board and administration of the institution. The institution grants the foundation the right to fundraise on its behalf and should collaborate closely with foundation boards and staff to identify specific functions to be performed by the foundation and how the
foundation board can best be engaged in support of the institution. Strategic and campaign planning, enterprise risk management processes, and transitions of senior institution and foundation administrators all afford opportunities to reassess, refine, and reaffirm foundation roles and functions.

2. Functions to be performed by the foundation and the respective responsibilities of the institution and foundation should be articulated in a memorandum of understanding (see AGB’s Illustrative Memorandum of Understanding between an Institution or System and a Foundation). The memorandum of understanding, sometimes called an operating agreement, should be periodically reviewed and updated.

3. The memorandum of understanding and other key policies relating to the institution-foundation relationship should be addressed at both campus and foundation board member orientation. While system boards should grant campus leaders broad discretion in determining how to work with affiliated foundations, they may set policies imposing certain requirements for relationships with affiliated entities.

4. Institution administrators should engage foundation board members and staff in strategic planning processes and in identifying and vetting fundraising opportunities and priorities. Working with foundation staff, they should ensure that the foundation board is well and regularly informed about evolving institutional challenges and opportunities and clearly articulated fundraising priorities. The foundation boards should, in turn, commit to support institutional plans and priorities and regularly assess its own priorities and agendas to ensure that they are well aligned with those of the institution. Providing the foundation board with regular opportunities to interact with academic leaders equips them with a richer understanding of the work of the institution and enables them to be more effective as fundraisers and advocates.

5. Foundations and institutions should speak with one voice. Institution boards and administrators are responsible for determining policy positions and advocacy agendas. Foundation boards can be valuable advocates on
behalf of their institutions, but should be guided in such work by institutionally defined priorities and undertake advocacy work in partnership with institution administrators. Foundations may identify policy issues relating to exempt-organization compliance regimes, charitable incentives, investment practices, and governance that would affect them independent of the intuition. In such cases they should work with institution staff and boards to ensure alignment of advocacy efforts.

Communication between Institution and Foundation Leaders

1. The institution president, chief financial officer, and chief development officer (if different from the foundation chief executive), should serve as ex-officio members of the foundation board or appropriate board committees. It may also be valuable to include the provost or other chief academic officer and executive director of the alumni association. While the institution president may be a voting member of the board, other ex-officio seats would typically be non-voting.

2. For institutions with campus boards, overlapping board membership, in which one or more members of the campus governing board serves as an ex-officio member of the foundation board, fosters alignment and helps ensure that the foundation board is well informed of evolving institutional issues and priorities. Service on foundation boards also helps foster a culture of philanthropy among members of the institution board.

3. Campus governing boards should, where possible, invite representatives of the foundation board to participate in meetings and serve on appropriate board committees and task forces. Board meetings might include formal reports by the foundation chief executive or chair or discussion of issues of common concern.

4. Deans, faculty, and other academic leaders should be periodically engaged in foundation board meetings and retreats to keep the foundation board
informed about research, programs, and initiatives on campus. Regular interactions between the foundation board and faculty also help build understanding of the foundation and foster a more inclusive culture of philanthropy.

5. The foundation chief executive should meet with campus leaders as a member, formal or informal, of the president’s cabinet. Regardless of the reporting relationship, regular meetings and ongoing communication between the president and foundation chief should be the norm.

6. The institution president, foundation chief executive, and chairs of the foundation and campus board (if applicable) should meet at least once annually to review the memorandum of understanding and other operating agreements and to discuss institution and foundation progress against goals and priorities. As suggested above, the foundation board would typically meet more frequently with the institution president and other senior administrators in normal board and committee meetings.

7. Institution and foundation boards should identify opportunities for joint meetings, retreats, and social events. Familiar, collegial relationships among boards make it far easier to address tensions and potential conflicts before they become serious. Joint retreats and planning discussions may benefit from support by external consultants or facilitators.

**Hiring, Reporting, Assessment, and Compensation of Employees**

1. Foundation chief executives may be employees of the institution, the foundation, or jointly employed by both. Employment, compensation, and reporting relationships of the foundation chief executive will be determined by institutional history and culture, the functions performed by the foundation, the institution’s advancement model, and financial resources available to the institution and foundation. Even foundations with very large endowments and revenues often rely on the support of institution employees
as well as fees for service or other funding from the institution. Reporting relationships, responsibility for hiring, assessing performance, and setting compensation should be clearly addressed in the memorandum of understanding between the institution and foundation.

2. In cases where the foundation chief executive is an employee of the university, the institution president should meaningfully engage the foundation board or its representatives in hiring and assessment processes.

3. Foundation boards should recognize that institution presidents are held accountable for fundraising, prudent and effective use of assets, stewardship of gifts, and maintaining the name and reputation of the institution. In cases in which the foundation chief executive is, in title or practice, the chief advancement or development officer of the university, a close partnership between institution president and foundation chief executive is vital. When the foundation chief executive is an employee of the foundation it is often appropriate for them to have a dotted line reporting relationship to the institution president, to participate regularly in cabinet meetings, and for the institution president to participate in hiring and assessment processes. In such cases the provost and deans may also be engaged in hiring and assessment of the foundation chief executive.

4. Both institution and foundation boards should work to support effective collaboration between the institution president and foundation CEO. It’s not unusual for new presidents to want to make changes to the composition of their cabinets. Familiarity with different institutional advancement models may lead new presidents to consider changes to the structure of development programs and reporting relationships. Both institution boards and presidents should recognize that major gift fundraising requires the sustained cultivation of relationships between donors and development officers. Foundation chief executives often have close and valuable ties to donors and prospects as well as well as community and corporate leaders and other constituents. Changes to senior development positions and
restructuring of development programs should only be undertaken in close consultation with the foundation board after careful consideration of the potential impacts, both positive and negative, on fundraising performance and relationships with donors and stakeholders.

5. Campus or system boards may ask foundations to provide funds to supplement the compensation of institution presidents or other senior personnel. Such requests should be made in writing, indicating the rationale for the payment and documenting the process by which the governing board has determined that the total compensation and benefits to be paid, inclusive of those provided by the foundation, are fair and reasonable. Ideally, funds designated for salary supplements for university personnel should be transferred from foundation to university accounts at the request of the institution’s governing board and distributed by the university through its normal payroll processes. Where state law renders it necessary for foundations to pay compensation to university employees directly, payments should be documented as outlined above. Foundation board members should not attempt to unduly influence the appointment of institution personnel.

6. Institution boards should engage foundation leaders in the hiring process for campus presidents. Campus presidents and administrators should also consult with foundation board leaders and engage them in the recruitment and selection processes of staff who will support the work of the foundation board or will otherwise work closely with foundation volunteers. In cases where the foundation is actively engaged in fundraising leadership, it can be valuable to include representatives of the foundation board in search committees or otherwise engage them in the recruitment process of provosts, deans, athletic directors, and other institution administrators who play an important role in fundraising. Not only can foundation volunteers provide helpful insights into a candidate’s potential fundraising capacity, but inclusion of board members in recruitment can help smooth leadership transitions and support effective collaboration going forward. Foundation board members can also play a valuable role in the onboarding and
orientation of campus presidents and other senior administrators, helping to familiarize them with institutional culture and facilitating introductions to community leaders and other important constituents.

7. Foundations may own or contribute to the maintenance or renovation of presidential residences and provide the use of aircraft or cars for use by institution personnel in fundraising other mission-related purposes. Foundations may also provide funding for travel, entertaining, club memberships, other expenses associated with fundraising and community relations. Such expenditures often draw media scrutiny and can damage presidential reputations and hurt fundraising. The use of foundation resources in ways that appear extravagant or more of a personal benefit should be handled with complete transparency. Decisions regarding salary supplements and major expenditures on presidential residences should be addressed by both institution and foundation boards and documented, even when donors designate funds for such purposes.

**Foundation Board Governance**

1. Foundation boards should conduct their business in accordance with the foundation’s articles of incorporation, by-laws, and board policies. (See *AGB Board of Directors’ Statement on the Fiduciary Duties of Governing Board Members*)

2. While foundation boards should have the authority to appoint their own members, the institution’s president and chief development officer should be actively engaged in the identification and selection of candidates. The foundation chief executive should review candidates for foundation board service with the institution president. Foundation governance committees should recognize that prospective board members will be charged with supporting and advancing the strategic priorities of the institution. Identifying candidates for board service who are committed to and
enthusiastic about institutional vision and strategy will help foster effective alignment of institution and foundation priorities. Foundation boards should have a written statement of expectation for board service, and boards should include individuals with the diverse skills and capacities required to provide effective oversight of foundation functions, philanthropic leadership, and strategic guidance and advocacy in support of the institution. (See the AGB’s Governance Committee for Foundation Boards for a discussion of board expectations, composition, assessment, and recruitment.)

3. As noted above, the inclusion of the institution president, other senior administrators, and representatives of the institution board as ex-officio members of the foundation board provides important channels of communication, helps ensure strategic alignment, and fosters trust and collaboration. The number of ex-officio positions should be limited to ensure that a majority of the board is independently appointed and engages the best candidates for board service.

4. Thoughtful self-reflection on governance practice is a hallmark of high-performing boards. Foundation boards should engage in regular self-assessment and periodic retreats. Inclusion of institution leaders in these processes can be very valuable, as can the use of external facilitators.

5. In addition to information about foundation operations and board responsibilities, foundation board orientation and ongoing board education should address issues of key strategic concern to the institution, institution plans and priorities, and other information necessary for the board to make informed decisions supporting the shared interests of the foundation and institution and to serve as effective advocates and champions of the institution.

6. Foundation board members should disclose potential conflicts associated with their service as well as disclosing transactions or other relationships with the institution that may create the appearance of personal benefit from their close relationship with the institution. Even though foundation board members do not have authority over institutional decisions, they are
generally perceived as having privileged influence within the institution. Any business or financial relationships they have with the institution should be managed to mitigate the appearance and reality of conflicts (see *AGB Board of Directors’ Statement on Conflict of Interest with Guidelines on Compelling Benefit*).

**Asset Management and Finance**

1. Foundation boards are responsible for decisions regarding the management, investment, and spending of endowment funds held by the foundation. Every state except Pennsylvania has adopted some variant of the Uniform Prudent Management of Institutional Funds Act that outlines factors boards should consider in making decisions regarding endowment spending and investment. Chief among these are the imperatives that restricted funds be spent in accordance with donor intent and, absent other stipulations regarding the spending or duration of the fund, that spending be calibrated to maintain the long-term purchasing power of the endowment. UPMIFA does allow boards flexibility and discretion in setting spending rates from year to year. Foundation boards should collaborate closely with the institution administration and board to help ensure that endowment distributions are predictable and managed to maximize current benefits while preserving intergenerational equity.

2. Accounting systems should enable donor-restricted funds to be tracked across foundation and university accounts from the point of gift acceptance to final expenditure by the institution and all fund administrators should have access to information regarding donor restrictions. Donor-restricted accounts at both the foundation and institution should be audited to ensure that funds are being spent in a timely manner and spent in accordance with donor intent (See *Understanding Foundation Finances: Financial Oversight and Planning for Foundation Boards*).
3. The foundation should provide the institution with regular reports on gift account balances and funds available for expenditure as well as projections on gift flows, investment performance, and anticipated endowment distributions for use in planning and budgeting. The institution should ensure that gift funds available for expenditure are spent in a timely manner and provide the foundation with information on the use of gift funds necessary for donor reports and stewardship. Excessive accumulation of unspent restricted funds in campus accounts is tantamount to a failure to fulfill donors’ intended charitable purposes. In cases where a donor’s purpose becomes impossible, impractical, or illegal to fulfill, UPMIFA may allow the foundation to identify an alternative charitable purpose.

4. Funding models for foundation operations and development activities, including determination of appropriate gift fees, should be developed collaboratively, recognizing that effective development programs require sustained investment. Many public institutions have historically underinvested in fundraising and advancement services. Analysis of investments and performance by peer institutions, assessments by external consultants, and use of internal metrics and benchmarking are all valuable in making decisions regarding investments in development and campaign budgets.

5. The institution and foundation should jointly develop gift acceptance policies, naming policies, and endowment policies and minimums. The institution and foundation should jointly agree on policies regarding the disposition of unrestricted gifts and bequests above a certain value.

6. The institution should develop policies to regulate funding requests to the foundation and expense reimbursements to be paid by the foundation to university personnel. In general, requests to the foundation to fund or support special projects should be channeled through the president or his/her designee. In cases where the foundation provides unrestricted funds
for discretionary use by the president or other administrators, such funds may be transferred to university accounts and administered by the university in keeping with institutional policy. In some cases it may be necessary for the foundation to reimburse institution administrators for expenses incurred or make payments directly from the foundation to vendors for expenses incurred by university personnel. Policies should be in place to ensure that any such expenses are reasonable and fulfill legitimate university purposes.

7. Foundation executives and campus administrators may differ on campaign and fundraising reporting. Institution presidents should understand and respect professional fundraising standards. See CASE Reporting Standards & Management Guidelines, The Donor Bill of Rights, and CASE’s Principles of Practice for Fundraising Professionals at Educational Institutions.