Conflict of Interest: IRS Sample Policy Annotated for Grantmakers

COUNCIL *on* FOUNDATIONS

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Introduction

What Is a Conflict of Interest?

The law requires individuals who manage and govern foundations ("fiduciaries") to exercise due care in administering the charity's affairs. This requirement is known as the duty of care. The law also prohibits fiduciaries from using their position to obtain personal gain for themselves or others at the charity's expense. This requirement is known as the duty of loyalty. Paying careful attention to transactions where there may be a conflict of interest ensures that a fiduciary does not breach his or her duties of care and loyalty to the organization. It can also help instill public trust by demonstrating that fiduciaries are committed to managing an organization with the utmost integrity and good faith and in the best interest of the organization and its charitable mission.

Conflicts of interest occur in our everyday lives when multiple loyalties pull us toward opposite courses of action. In the context of charities, a conflict of interest may occur when personal interests prevent an individual from making an impartial decision that is in the best interest of the charity. Applicable legal standards and prohibitions differ depending on whether the charity involved is a public charity or a private foundation, whether the transaction is financial or non-financial in nature, whether state or federal law is most pertinent and whether the charity is organized as a trust or a corporation.

A written conflict of interest policy that is enforced provides safeguards to prevent transactions that may violate the law or a fiduciary's duty of loyalty. A written policy can also help boards spot transactions that give the appearance of a conflict of interest before they occur.

What Is the IRS Sample Policy?

What do regulators think a conflict of interest policy should look like? On the recently revised application for tax-exempt status (Form 1023), the IRS asks new organizations whether they have adopted a written conflict of interest policy that is consistent with a sample included in the instructions (and to attach a copy of the policy). If a policy has not been adopted, the IRS requires applicants to describe the procedures the organization will follow to safeguard against improper conflict of interest transactions. Similar questions will most likely appear on Forms 990 and 990PF in the future.

Does the IRS model work for grantmakers? The IRS's sample policy was drafted back in the late 1990s as a guide for healthcare organizations. It was developed with public charities in mind and with a particular focus on financial conflicts of interest between a charity and directors and officers, and also physicians. The IRS policy included in the instructions to Form 1023 highlights the provisions that are applicable only to healthcare systems. Private foundations may want to evaluate whether the sample policy is a good fit for them, and all grantmakers may wish to include statements about non-economic conflicts of interest. The following is a reprint of the IRS sample policy's provisions, with comments from the Council on how grantmakers might consider revising the policy.

IRS Sample Policy with Comments from the Council on Foundations

ARTICLE I: Purpose

IRS Provision:

The purpose of the conflict of interest policy is to protect this tax-exempt organization's (Organization) interest when it is contemplating entering into a transaction or arrangement that might benefit the private interest of an officer or director of the Organization or might result in a possible excess benefit transaction. This policy is intended to supplement but not replace any applicable state and federal laws governing conflict of interest applicable to non-profit and charitable organizations.

Council Comments:

Why have a written conflict of interest policy? The law requires individuals who manage and govern charities to exercise due care in administering the charity's affairs and prohibits them from using their position to obtain personal gain for themselves or others at the charity's expense. A written conflict of interest policy is a practical way to provide safeguards to prevent transactions that result in private benefit at the charity's expense. As discussed below, grantmakers may wish to have one conflict of interest policy that applies to all board members and staff, but they could also have separate policies for board members and staff.

Must the policy address every possible conflict of interest situation? Grantmakers may wish to state that their policies serve as guidelines for addressing conflicts of interest and cannot cover every possible situation that may arise. Some policies describe the general intent of the policy and the values that should guide decisionmaking. Public charity grantmakers' conflicts policies often cite a desire to maintain public trust. Private foundations may cite the importance of fairness or integrity or upholding the values of a founding individual family or company.

Although not every situation may be addressed by the policy, grantmakers should ensure that the most common types of situations that arise for their foundations are covered. To help with drafting policies, grantmakers should make a list of the most common types of situations that arise, as well as the ones they feel the policy should address.

Will complying with a conflict of interest policy satisfy the foundation's legal obligations? As the IRS policy makes clear, a written policy is not a substitute for complying with legal requirements. Charities must be aware of federal and state laws that regulate conflict of interest transactions. Some states may require a charity to have a conflict of interest policy.

Which federal rules are most applicable to conflict of interest situations? Private foundations may want to include a reference to the self-dealing rules under federal law (for a summary of the federal rules, see Appendix A). The prohibition against self-dealing precludes private foundations from entering into a variety of financial transactions (with some limited exceptions) with “disqualified persons”—even if the terms are favorable to the foundation. For public charities, such as community foundations, financial transactions between the charity and its board members—as well as other “insiders”—are covered by the prohibition against excess benefit transactions, commonly known as the “intermediate sanctions” rules (for a summary of the rules, see Appendix B). If any payments to such insiders—including salaries and payments for goods or services—exceed fair market value, the insiders, and possibly members of the organization’s board, will be subject to penalty excise taxes.

Should the policy include a confidentiality provision? Some charities include a confidentiality provision in their conflict of interest policies (others include this provision in personnel policies). The intent is to inform all relevant individuals that confidential information acquired in connection with a person’s work for the organization should not be used for personal benefit. Some foundations specifically address the use of information acquired with respect to the foundation’s investments.

ARTICLE II: Definitions

IRS Provision:

1. Interested Person

Any director, principal officer, or member of a committee with board delegated powers, who has a direct or indirect financial interest, as defined below, is an interested person.

[Hospital insert—If a person is an interested person with respect to any entity in the health care system of which the organization is a part, he or she is an interested person with respect to all entities in the health care system.]

2. Financial Interest

A person has a financial interest if the person has, directly or indirectly, through business, investment or family:

a. An ownership or investment interest in any entity with which the Organization has a transaction or arrangement,

b. A compensation arrangement with the Organization or with any entity or individual with which the Organization has a transaction or arrangement, or

c. A potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the Organization is negotiating a transaction or arrangement.

Compensation includes direct and indirect remuneration as well as gifts or favors that are not insubstantial.

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest only if the appropriate governing board or committee decides that a conflict of interest exists.

Council Comments:

Is the IRS policy sufficiently broad for grantmakers? The policy should define to whom it applies and the scope of conflicting interests it means to regulate. The IRS policy is limited to safeguarding against improper financial transactions between the charity and directors and officers.

Grantmakers often have all manner of established advisory committees in operation; the policy should be clear in its application to members of these groups. The policy should also define who constitutes a member of an interested person's family. The definition of "disqualified persons" from the self-dealing rules in the federal tax code is a good starting point for private foundations, but it may be underinclusive. For example, siblings are not considered to be disqualified persons.

Grantmakers' policies may also cover staff members. Some policies are written to include both board members, senior executives and staff, while others include only board members and a separate policy is prepared for staff as part of a foundation's personnel policies.

Grantmakers may also wish to note that not every conflict of interest is financial; directors and staff members may have personal or political involvements that may cause them to have dual and conflicting loyalties in connection with a grant or other foundation expenditure. Most policies explicitly address conflicts in reviewing and awarding grants.

Are "interested persons" under the IRS policy the same as "disqualified persons" under the self-dealing and intermediate sanctions rules? Private foundations must keep in mind that the IRS policy's definition of "interested persons" is different from—and less inclusive than—the federal tax code's definition of "disqualified persons," that group of donors, directors and their family members and business interests with which the foundation is barred from entering into an array of financial transactions. The same is true for the definition of "disqualified persons" under the intermediate sanctions rules that apply to public charities. Private foundations and public charities should identify all the disqualified persons in relation to them. Some organizations use the conflict of interest policy to educate affected individuals about self-dealing transactions prohibited by the tax code or the intermediate sanctions rules by providing a reference to the rules or even a brief summary of what the rules require (for a summary of the federal rules, see Appendixes A and B).

Will private foundations satisfy their legal obligations if they adopt the definition of "financial interest" in the IRS policy? Private foundations must keep in mind that some financial interests, as defined by the IRS policy, may constitute self-dealing. In this case, the determination whether a financial interest is a conflict of interest is taken out of the hands of the governing board or committee. In contrast, some foundations may also wish to specify what type of transactions will not ordinarily constitute a prohibited conflict of interest. For example, a company foundation might state that a request for payment by an interested person under a matching gift program to a charity in which the person has a personal or financial interest will not ordinarily constitute a prohibited conflict of interest.

ARTICLE III: Procedures

IRS Provision:

1. Duty to Disclose

In connection with any actual or possible conflict of interest, an interested person must disclose the existence of the financial interest and be given the opportunity to disclose all material facts to the directors and members of committees with governing board delegated powers considering the proposed transaction or arrangement.

2. Determining Whether a Conflict of Interest Exists

After disclosure of the financial interest and all material facts, and after any discussion with the interested person, he/she shall leave the governing board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.

3. Procedures for Addressing the Conflict of Interest

   a. An interested person may make a presentation at the governing board or committee meeting, but after the presentation, he/she shall leave the meeting during the discussion of, and the vote on, the transaction or arrangement involving the possible conflict of interest.
   b. The chairperson of the governing board or committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.
   c. After exercising due diligence, the governing board or committee shall determine whether the Organization can obtain with reasonable efforts a more advantageous transaction or arrangement from a person or entity that would not give rise to a conflict of interest.

d. If a more advantageous transaction or arrangement is not reasonably possible under circumstances not producing a conflict of interest, the governing board or committee shall determine by a majority vote of the disinterested directors whether the transaction or arrangement is in the Organization's best interest, for its own benefit, and whether it is fair and reasonable. In conformity with the above determination it shall make its decision as to whether to enter into the transaction or arrangement.

4. Violations of the Conflicts of Interest Policy

a. If the governing board or committee has reasonable cause to believe that a member has failed to disclose actual or possible conflicts of interest, it shall inform the member of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.

b. If, after hearing the member's response and after making further investigation as warranted by the circumstances, the governing board or committee determines the member has failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

Council Comments:

Are detailed procedures for dealing with conflicts of interest necessary if the goal is to avoid all actual and potential conflicts of interest? Some policies have a blanket rule that requires avoiding all actual and potential conflicts of interest that are disclosed. If the governing board of a foundation makes a reasonable determination that the organization can properly function under such a broad prohibition, then the procedures outlined in the IRS policy become unnecessary. Most foundations recognize that some conflicts—and the appearance of conflicts—are unavoidable and thus include procedures for dealing with them. Formulators of the policy need to consider whether they wish to address these situations in advance or provide for ad hoc resolution.

One common situation that many policies address is the acceptance of gifts, favors or honoraria from businesses and charities that have dealings with the foundation. Most foundations adopt a blanket prohibition on these gifts, with an exception for incidental or tenuous gifts, such as reasonable meals in connection with business meetings or low-cost promotional gifts.

Are the procedures in the IRS policy sufficient to meet grantmakers' legal obligations under state and federal laws? The IRS policy tracks many states' laws on how to resolve conflicts of interest for charities organized as nonprofit corporations. It is important to note that the IRS developed the policy for public charities. Certain financial transactions that may be entered into pursuant to the IRS policy may be prohibited for private foundations by the federal tax code. In addition, foundations organized as charitable trusts may also be subject to strict state trust laws that may prohibit some financial transactions with trustees. Finally, all charities should be aware of any restrictions that may appear in their organizing documents (articles of incorporation, bylaws, trust instrument, etc.) relevant to handling conflicts of interest situations.

All charities should remember that the procedures outlined by the IRS policy are useful guidelines to follow in many different types of conflict of interest situations. Grantmakers develop provisions that specifically address issues related to their grantmaking procedures. Many cover staff, such as program officers, who review and make recommendations about grant awards. The guidelines can be used in handling investment decisions, especially in hiring and retaining investment managers, and in developing gift acceptance policies for community foundations.

Duty to disclose. An interested person must disclose any actual or potential conflict of interest, and disinterested individuals (whenever possible) should decide if there is an actual or potential conflict of interest. The duty to disclose should be ongoing, in addition to filling out disclosure forms on a periodic basis (see comments to Article VI: Annual Statements).

It is important to note that no amount of disclosure or independent ratification (e.g., by a court) can correct an act of self-dealing that occurs between a private foundation and a disqualified person. In contrast, state law may provide that for public charities a conflict of interest transaction may be valid as long as it is fair to the organization.

Determining whether a conflict of interest exists. The IRS policy requires the conflicted person to leave the room while disinterested members discuss and decide if a conflict of interest exists. Interested persons should not be allowed to influence the decisionmaking process, whether inside or outside a meeting. Grantmakers may develop a policy that prohibits certain types of conflicted transactions (financial or non-financial), whether or not they would be construed to be a conflicted transaction by disinterested individuals.

Procedures for addressing the conflict of interest. If a conflict of interest exists, the IRS policy requires the board or a committee to determine, if appropriate, whether the charity can obtain a more advantageous arrangement that would not pose a conflict of interest. Even if an alternative arrangement is not possible, the board or committee must conclude, by a majority vote of disinterested directors, that the transaction is in the charity's best interest and it is fair and reasonable. In some cases, the governing board of a private foundation composed of family members may not be able to approve any transaction by a vote of disinterested directors.

Violations of the conflicts of interest policy. The IRS policy states that appropriate remedies will be taken in case of violations of the conflict of interest policy. The policy does not specify what types of disciplinary or corrective actions may be taken. Some foundations do state that the remedy for a violation may include termination of employment or removal from the board. Some policies provide for procedures in handling investigations of alleged violations.

ARTICLE IV: Records of Proceedings

IRS Provision:

The minutes of the governing board and all committees with board delegated powers shall contain:

a. The names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present, and the governing board's or committee's decision as to whether a conflict of interest in fact existed.

b. The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection with the proceedings.

Council Comments:

Should everything required by the IRS policy be recorded? Detailed and contemporaneous documentation may be important for legal compliance, as well as to demonstrate that the organization is enforcing its policy. The IRS policy requires that the board minutes reflect the disclosure, discussion and resolution of the determination of whether a conflict of interest exists. The same documentation should be made for the resulting transaction, if any, finally approved. The minutes of board and committee meetings should include (1) who is the conflicted person; (2) a description of the conflict; (3) members present during the debate; (4) whether the conflicted person was present during the debate; (5) the content of the discussion; (6) members who voted; (7) the result of the vote; and (8) any action taken as a result of the vote.

ARTICLE V: Compensation

IRS Provision:

a. A voting member of the governing board who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.

b. A voting member of any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.

c. No voting member of the governing board or any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization, either individually or collectively, is prohibited from providing information to any committee regarding compensation.

d. [Hospital insert—Physicians who receive compensation from the Organization, whether directly or indirectly or as employees or independent contractors, are precluded from membership on any committee whose jurisdiction includes compensation matters. No physician, either individually or collectively, is prohibited from providing information to any committee regarding physician compensation.]

Council Comments:

Are there additional rules grantmakers should follow when determining compensation? The IRS policy prohibits individuals from voting on matters related to their own compensation. Private foundations should exercise great caution when they hire foundation insiders—family members or board or committee members—to perform professional services to ensure compliance with the self-dealing provisions of the federal tax code. Public charity grantmakers should comply with the regulations and procedures found in the "intermediate sanctions" rules in section 4958 of the tax code. To the extent possible, private foundations should also follow the procedures for determining compensation in the intermediate sanctions rules.

Should a compensation committee set remuneration? Some foundations address matters related to compensation of directors and officers in a separate compensation policy, which may be prepared by the compensation or other similar committee for adoption by the full board. The policy may include specific steps that the foundation would follow in determining compensation of directors and officers, as well as a general compensation philosophy statement. It should be noted that even if a board committee is delegated authority to approve compensation, all board members should be knowledgeable of what actions the committee is taking, and in general the full board should approve the compensation policy developed by the committee and should approve the compensation of some officers, such as the president.

Foundations should be aware of any state law requirements for approving compensation. The recently enacted California Nonprofit Integrity Act of 2004 provides that the compensation of certain executive officers must be reviewed and approved by the governing board or an authorized committee to ensure that the payment is "just and reasonable." Some state laws may also dictate the composition of a board or committee by prohibiting staff members from serving on a board or committee or requiring the presence of a certain number of independent members to serve on a board or committee.

ARTICLE VI: Annual Statements

IRS Provision:

Each director, principal officer and member of a committee with governing board delegated powers shall annually sign a statement which affirms such person:

a. Has received a copy of the conflicts of interest policy,

b. Has read and understands the policy,

c. Has agreed to comply with the policy, and

d. Understands the Organization is charitable and in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes.

Council Comments:

Should grantmakers require annual written disclosure? The IRS policy requires only an annual certification that the directors and officers have read and understood the policy and agree to comply with it. All grantmakers should require as much.

Some foundations go further and require periodic statements from individuals covered by conflict of interest policies that disclose the financial, vocational and charitable ties of these individuals and their family members that may give rise to conflicts. Most policies require disclosure of only current conflicts, but some may require individuals to disclose immediate past conflicts. All disclosure statements should be kept confidential and access to them should be limited to persons who have a reasonable need to know their contents.

Even if annual disclosure is required, all covered individuals should be under a continuing obligation to disclose any actual and potential conflicts of interest as they may arise. Although a foundation could require periodic written disclosure or simply disclosure of any actual or potential conflicts prior to a vote, the written disclosure could play an important role in demonstrating that the foundation is enforcing its policy during an external audit. Written disclosure can also ensure that conflicts are not inadvertently ignored. Finally, annual disclosure is a good way to review the requirements of the policy with the board and other covered individuals on a periodic basis.

What should grantmakers do if a board member refuses to sign the policy or fill out the disclosure form?
Grantmakers should provide for an appropriate remedy in case a board member refuses to sign a policy or complete a disclosure form. Grantmakers may want to make clear to prospective board members that complying with all the requirements of a policy is a condition of being elected to and remaining on the board. A clear explanation of the policy may be all that is required, since the individual may be refusing to sign as a result of a misunderstanding of the policy.

Foundations may face a situation where there is a valid reason that the individual does not wish to make all of his or her personal or business connections known. In this case, it may be appropriate to take additional steps to ensure confidentiality. Where the reason for refusal to sign the policy or disclose conflicts is not acceptable to the foundation, the individual may be subject to termination or removal pursuant to the foundation's general policies.

ARTICLE VII: Periodic Reviews

IRS Provision:

To ensure the Organization operates in a manner consistent with charitable purposes and does not engage in activities that could jeopardize its tax-exempt status, periodic reviews shall be conducted. The periodic reviews shall, at a minimum, include the following subjects:

a. Whether compensation arrangements and benefits are reasonable, based on competent survey information, and the result of arm's length bargaining.

b. Whether partnerships, joint ventures, and arrangements with management organizations conform to the Organization's written policies, are properly recorded, reflect reasonable investment or payments for goods and services, further charitable purposes and do not result in inurement, impermissible private benefit or in an excess benefit transaction.

Council Comments:

Should grantmakers review only financial transactions? The IRS policy requires the organization to conduct periodic reviews of its compensation practices, and other acquisitions policies, to ensure compliance with the federal tax code.

Compliance with the periodic review provision of the IRS sample policy may require hiring an attorney or other outside expert (see Article VIII: Use of Outside Experts below). At a minimum, charities and grantmakers will want to periodically review their compensation practices, conflict of interest policies, grantmaking policies and investment policies. Private foundations will also want to ensure that they are complying with the self-dealing requirements of the tax code.

ARTICLE VIII: Use of Outside Experts

IRS Provisions:

When conducting the periodic reviews as provided for in Article VII, the Organization may, but need not, use outside advisors. If outside experts are used, their use shall not relieve the governing board of its responsibility for ensuring periodic reviews are conducted.

Council Comments:

Does the law provide a safe harbor to directors if outside experts are hired to conduct periodic reviews? The periodic review provision in Article VII of the IRS sample policy is intended to ensure that the organization complies with the prohibition against providing impermissible private benefit at the expense of the charity.

Article VIII provides that the board may delegate the function of conducting periodic reviews to outside experts. Board members do not have to be experts and opine on the legality of every transaction that a foundation may enter into. Members of the governing board will generally fulfill their fiduciary duties if they exercise due care in selecting qualified experts to review transactions, ensure that the reviews are done, and reasonably rely on the opinions of qualified experts.

The federal tax rules provide an additional safe harbor to board members of private foundations who approve a self-dealing transaction based on an expert's advice. Even if it turns out that the transaction violates federal rules, the board members may, in certain circumstances, avoid incurring personal penalties by showing that they reasonably relied on appropriate professional advice. Directors of a private foundation may rely on a reasoned opinion of legal counsel that an act is not a self-dealing transaction. The opinion must reach a conclusion based on all material facts and an analysis of applicable law.

A similar—but somewhat broader—safe harbor is available to board members of public charities under the intermediate sanctions rules. For directors of public charities, the intermediate sanctions rules allow board members to rely on the written advice of professionals specified in the Treasury Regulations. These include legal counsel, certified public accountants and accounting firms with relevant tax law expertise, and independent valuation experts. The Regulations define who will qualify as an independent valuation expert, but appropriate compensation consultants will generally qualify.

Appendix A

Summary of Private Foundation Self-Dealing Regulations Section 4941 of the Internal Revenue Code

The Internal Revenue Code and Treasury Regulations prohibit private foundations from engaging in acts of "self-dealing" with "disqualified persons."

Disqualified persons with respect to a foundation include:

- foundation managers (officers, directors, trustees, or individuals with similar responsibilities);
- substantial contributors (defined as any person who has contributed an aggregate amount of more than $5,000 to a private foundation, if such amount is more than 2% of the total contributions received by the foundation before the end of the year in which the person makes a contribution);
- individuals who own more than 20% of a business enterprise that is a substantial contributor;
- family members of any person described above (spouse, ancestors, lineal descendants and spouses of lineal descendants);
- corporations, partnerships, and trusts or estates in which a person described above owns more than 35% of the voting power, profits interest, or beneficial interest;
- government officials.

Disqualified persons are prohibited from entering into the following types of transactions under the self-dealing regulations:

- *sale, exchange or leasing of property* between a private foundation and a disqualified person;
- *lending of money or other extension of credit* between a private foundation and a disqualified person, other than the lending of money by a disqualified person to the foundation without interest or other charge, so long as the loan proceeds are used exclusively for charitable purposes;

- *furnishing of goods, services and facilities* between the foundation and a disqualified person, other than the furnishing of goods, services or facilities by a disqualified person to the foundation without charge so long as the goods, services or facilities are used exclusively for charitable purposes; the foundation may furnish goods, services and facilities to a disqualified person so long as they are furnished on a basis no more favorable than that on which they are made available to the general public;
- *payment of compensation (or payment or reimbursement of expenses)*, other than the payment of compensation and the payment or reimbursement of expenses by the foundation to a disqualified person for "personal services" that are reasonable and necessary to carrying out the exempt purposes of the foundation, so long as the compensation, payment, or reimbursement is not excessive ("personal services" include foundation management by trustees, directors and officers, legal and accounting services, and investment management; payment of directors' and officers' (D&O) liability insurance premiums on behalf of trustees and directors can be part of a reasonable (not excessive) compensation package);
- *transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation*, except when the benefit is incidental and tenuous, such as some public recognition for grants;
- *payment to government officials*;
- *transaction involving corporate securities*, except under narrow conditions (corporations that are disqualified persons generally may not purchase or exchange securities from their sponsored charitable foundations).

Appendix B

Summary of Excess Benefit Transaction Regulations ("Intermediate Sanctions"): Section 4958 of the Internal Revenue Code

The Internal Revenue Code and Treasury Regulations prohibit public charities from providing "excessive" (more than fair market value) economic benefits to "disqualified persons." The Regulations set forth procedures, or "rebuttable presumption" rules, that, if followed, provide a presumption of reasonableness for transactions between a public charity and a disqualified person.

Disqualified persons with respect to a public charity include:

- individuals who are in a position to exercise substantial influence over the affairs of the organization, including:
  - foundation managers (officers, directors, trustees, or individuals with similar responsibilities),
  - founder of the organization,
  - substantial contributors (defined as any person who has contributed in the current fiscal year and the four preceding fiscal years more than $5,000, if such amount is more than 2% of total contributions received during that five-year period by the organization), and
  - other individuals based on a facts and circumstances test;
- any of the persons listed above who has been in a position to exercise substantial influence over the affairs of the organization during the past 5 years;
- family members of any person described above (spouse, siblings, spouses of siblings, ancestors, lineal descendants and spouses of lineal descendants);
- corporations, partnerships, and trusts or estates in which a person described above owns more than 35% of the voting power, profits interest, or beneficial interest;

All transactions that provide an economic benefit disqualified persons—such as compensation for services and purchases and sales of property—are subject to the intermediate sanctions rules, whether the transactions are done directly by the organization or indirectly through a controlled entity (taxable or tax-exempt) or an intermediary.

Under the Regulations implementing the intermediate sanctions rules, three conditions must be satisfied to take advantage of the rebuttable presumption. These include:

- approval by disinterested governing board (or committee) before the transaction is entered into;
- reliance on comparable data to determine that the economic benefit provided to a disqualified person does not exceed fair market value for the services or property provided by the disqualified person in return; and
- concurrent documentation that adequately documents the basis for making the determination that the transaction is reasonable (the Regulations specifically provide what information must be documented).

Appendix C

Council Resources

"Conflicts of Interest: Safeguarding Your Foundation" (2005) (compilation of four articles written by the Council's legal staff and sample policies)
http://www.cof.org/files/Documents/Building%20Strong%20Ethical%20Foundations/Conflicts_of_Interest_Safeguarding_Your_Foundation.pdf

(September 1997) www.cof.org/Content/General/Display.cfm?contentID=172.

Sarita Venkat, "Director Independence and Charitable Contributions," *Foundation News & Commentary* (May/June 2005) www.foundationnews.org/CME/article.cfm?id=3269&issueID=&authByte=60381&profileID=.

"Determining Reasonable Compensation for Foundation Directors and Trustees" (a guidance memorandum from the Board of Directors of the Council on Foundations) (December 2002) www.cof.org/files/Documents/Governing_Boards/trusteecomp2003.pdf.

"Recommended Best Practices in Determining Reasonable Executive Compensation" (a guidance memorandum from the Board of Directors of the Council on Foundations) (December 2002) www.cof.org/files/Documents/Governing_Boards/execcomp2003.pdf.

Other Resources

The new Form 1023, Application for Recognition of Exemption, is available for download in pdf format at www.irs.gov/pub/irs-pdf/f1023.pdf. The instructions for the form, which include the IRS sample conflict of interest policy, are available at www.irs.gov/pub/irs-pdf/i1023.pdf.

BoardSource and the Council of Michigan Foundations, "Conflicts of Interest at Foundations: Avoiding the Bad and Managing the Good" (2005) www.cmif.org/Documents/COI_Guide.pdf.