

Good governance is a tool for keeping a foundation out of legal trouble. By remaining well-informed, attentive, and honest, foundation trustees should rarely, if ever, be subject to removal or financial sanctions. That is true even if the trustees occasionally, in good faith, make errors of judgment.

Even honest and hardworking foundation leaders can be sued or threatened with suit, however, or can inadvertently violate the private foundation tax rules. For that reason, every foundation should consider obtaining insurance coverage for its trustees and officers. This insurance – commonly known as “directors and officers” or “D&O” insurance — should cover defense costs as well as any damages, taxes, or fines that must be paid.

The component parts of this insurance should be reviewed carefully with counsel, to help the foundation assess whether the insurance is adequate to cover the relevant categories of potential liability.

Some types of insurance may be deemed “non-compensatory” and other types “compensatory,” which will affect whether the premium payments must be treated as taxable income by those who are insured. Premiums for “compensatory” insurance — for example, insurance covering liability for the private foundation taxes — must be taken into account when evaluating the over-all reasonableness of the compensation a trustee or officer receives.

Those who receive insurance coverage from a foundation should consult with their own tax advisors about the income tax consequences of the premium payments.

For cases that insurance does not cover or situations in which an advance is needed to cover legal or other expenses, an indemnification from the assets of the foundation also may be appropriate, subject to applicable legal limits.