BESSEMER TRUST

ACTEC 2017 Summer Meeting Musings (Including "Life Cycle of a Charity")

June 2017

The American College of Trust and Estate Counsel is a national organization of approximately 2,600 lawyers elected to membership. One of its central purposes is to study and improve trust, estate and tax laws, procedures and professional responsibility. Learn more about ACTEC and access the roster of ACTEC Fellows at **www.actec.org**.

This summary reflects the individual observations of Steve Akers from the seminars at the 2017 Summer Meeting and does not purport to represent the views of ACTEC as to any particular issues.

Steve R. Akers

Senior Fiduciary Counsel — Southwest Region, Bessemer Trust
300 Crescent Court, Suite 800
Dallas, TX 75201
214-981-9407
akers@bessemer.com
www.bessemer.com

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Important Information Regarding This Summary

This summary is for your general information. The discussion of any estate planning alternatives and other observations herein are not intended as legal or tax advice and do not take into account the particular estate planning objectives, financial situation or needs of individual clients. This summary is based upon information obtained from various sources that Bessemer believes to be reliable, but Bessemer makes no representation or warranty with respect to the accuracy or completeness of such information. Views expressed herein are current only as of the date indicated, and are subject to change without notice. Forecasts may not be realized due to a variety of factors, including changes in law, regulation, interest rates, and inflation.

Introduction

Some of my observations from the 2017 ACTEC Summer Meeting Seminars in Seattle, Washington on June 14-17, 2017 are summarized below. (At the request of ACTEC, the summary does not include any discussions at Committee meetings.) This summary does not contain all of the excellent information from the seminars, but merely selected issues. The summary is based on the presentations at the seminars, but the specific speakers making particular comments typically are not identified.

Items 1-23 come from the "Stand Alone" program titled "The Life Cycle of a Charity." Items 24-38 come from a seminar titled "Cultural Variables in the Estate Planning Relationship."

Dennis Belcher Remembrance

Dennis I. Belcher died unexpectedly on April 27, 2017. Dennis was the President of ACTEC in 2009-2010 and made innumerable contributions to ACTEC, the estate planning profession, and the development of laws in the estate planning area. A memorial event honoring Dennis was attended by a large number of Fellows at the Summer Meeting. At the beginning of the professional seminars, Edward Beckwith delivered the following tribute to Dennis:

> It is fitting that we note the loss of such a good friend at the start of this program. Like many of you, I had the good fortune to know Dennis Belcher as a devoted husband and father, as well as a tireless colleague and the loyalist of friends. He had a famous sense of humor and always put the interests of others first.
>
> Dennis was the consummate trusted advisor and he was a legal visionary and a courageous leader. His leadership has left lasting legacies at his firm and on his community, our profession and most assuredly our College.
>
> It was Dennis who focused on our need for more collaborative attention to the financial stability of the College. And it was his vision to relocate the College from Los Angeles to Washington while totally remaking our legal structures and staff along the way. In the end, the total makeover of our College and Foundation was accomplished ahead of schedule and under budget.
>
> And let's not forget innovations like our Stand Alone programs. That was Dennis's idea too.
>
> It was our collective good fortune that someone as talented as Dennis was as generous as he was with his time and his talent. What we do here today and tomorrow is a fitting tribute to his life and to his memory.
>
> Edward Jay Beckwith

Items 1-23 are observations from seminars about "The Life Cycle of a Charity." The written materials for these seminars were prepared largely by Edward Beckwith and some of this summary is taken verbatim from those excellent materials. Some of these materials are based, in part, on materials in Jerry J. McCoy & Kathryn Miree, Family Foundation Handbook (2015). Edward Beckwith, Martin Hall, and Michelle McKinnon participated in each of these various seminars.

1. Significance for Estate Planning Professionals

The following is Ed Beckwith's summary of the significance of this series of panels about the Life Cycle of a Charity:

> Like many for-profit entities, and all of our clients and their families, charities have life cycles. Before they are even created, they are conceived in the minds of one or more individuals, in each case to accomplish one or more important goals. Whether to develop and operate a museum, school, zoo, health care research facility, or to create a mechanism by which gifts can be made to accomplish charitable goals, each charity is created using legal structures and seeks the imprimatur of federal, state, and local authorities to operate.
>
> Over time, a charity may never have an employee, own or even use real estate, or have a need for ongoing legal advice. Many others, however, will operate much as for-profits operate including the following: hiring and firing employees with all of the complexities of employment agreements, compensation and benefits structures, termination arrangements, etc.; purchasing or renting buildings or offices; dealing with outside vendors; dealing with the press and public, etc. Sometimes, perhaps most times, changing circumstances call into question the continued vitality and relevance of a given charity. In some cases, the leadership and stakeholders are able to reinvigorate the charity. Often, however, a charity will lose its purpose or support and cease to exist by merger or liquidation, or even bankruptcy when liabilities exceed available assets.
>
> Most ACTEC Fellows touch on these life cycles issues in their representation of clients who lead and support various charitable causes. In addition, many Fellows serve on charitable boards and represent the charities themselves. [These panels represent a] robust, multi-disciplinary examination of how each of these stages in the life of a charity relates to the others, the legal issues involved, and how and when to invite other advisors (business, management, real estate, employment, bankruptcy, etc.) into the process to help address these issues and challenges.

Items 2-6 are observations from a panel of Anne LeBleu and Shelly Whelpton, both with Arabella Advisors, in Washington D.C. (together with Ed Beckwith, Martin Hall, and Michelle McKinnon, who participated in most of the panels about The Life Cycle of a Charity), discussing "The Philanthropic Spark."

2. Huge Scope of Philanthropy

In 2016, $373.25 billion was donated to charitable causes, 70.8% of that from individuals. About 1/3 of the contributions were to religious organizations, and about 1/3 were given collectively to education, health care, and human services causes.

3. Personality Types of Donors

Why does a donor want to support a particular charitable cause, and what factors drive the impulse to give? The personality types of donors add insight to these issues.

Communitarian. These donors are deeply engaged in the community. Being the "bad guy" on a board can be difficult because of the deep relationships with the community. This type of donor, even when making a large bequest or grant, may feel awkward about asking for something in exchange for the donation because of deep relationships on the board.

Investor. Business skill sets are super important to this type of donor. They will focus on measuring impact and be mindful of dollars that are spent. A challenge will be balancing their business experiences with the realities of how nonprofit organizations operate, often under tight resource constraints. Engaging the next generation, often without the same business acumen, can be difficult for these donors.

Socialite. The socialite donor can get frustrated if grants are not used wisely, when the grants were made based on close personal relationships. Adding more rigor to the charitable giving decision-making process can be helpful for these donors.

Altruist. Altruist donors have great passions and intentions, but can be deeply hurt if charitable goals are not met.

Devout. Giving may feel like an obligation for some devout donors. These donors may not do as much thinking or strategizing about change that they want to see in the world.

Repayer. These donors may give out of guilt.

Dynast. These donors have a diverse giving portfolio, and may not play an overly active role in any single organization. Spreading gifts widely may minimize the potential impact of the gifts. Family tensions may arise if other family members don't share the same charitable viewpoint.

Planning Implications. Planners should be aware of the sensitivities of these various donor types and should assist donors in looking at facts rather than just emotion to strategize the most effective ways that charitable contributions can be used to make an impact.

4. Overview of Thoughtful Process for Charitable Giving

A three-part donor-centric process includes the following: (i) Setting donor goals (for example, asking, "If you could change one thing in the world, what would it be?"); (ii) Identifying the donee (including matching resources to needs; examining the landscape of potential players that could work together; and considering how the donor's philanthropic capital and relationships could be most impactful); and (iii) Selecting the best planning vehicle (including the structure of the gift generally (for example, outright or in trust?), and other strategies such as bargain sales, partial interest gifts, gift restrictions, etc.).

One of the things that Arabella Advisors does is work with donors to be innovative to develop a shared mission and vision and to maximize the impact of charitable giving for a specific cause, based on the donor's vision, values, and legacy—a process they refer to as "impact investing." This may be accomplished by donating to existing public charities or organizations, and is sometimes best accomplished through fiscal sponsorships with project incubators for new initiatives.

5. Tax Deduction Considerations for Donor

a. **Income Tax Charitable Deduction Percentage Limitations.** No charitable income tax deduction is available unless the donor-taxpayer itemizes. Income tax deductions are generally limited to a specified percentage of a donor's contribution base (essentially adjusted gross income), based on the type of charitable entity (public charity vs. private foundation) and the type of asset that is given. Under §170(d), a

five-year carryforward of the income tax charitable deduction is available to the extent that the percentage limitations limit immediate deduction. The §68 limitation on itemized deductions may also further reduce the allowable deduction.

Various limitations apply to the deductibility of contributions to private foundations that do not exist for gifts to public charities. Gifts of cash or unappreciated property to private foundations are subject to a 30% limitation, compared to a 50% limitation for gifts to public charities. Gifts of capital gain property to a private foundations are subject to a 20% limitation, compared to 30% limitation for like gifts to public charities. Furthermore the deduction for gifts of appreciated capital gain property to a private foundation is limited to the lesser of the property's basis or fair market value, except for a contribution of "qualified appreciated stock" (generally, publicly traded stock, for which the deduction is based on the property's fair market value). In many situations, however, the ability of the donor to avoid paying capital gains tax on an asset that would otherwise be sold is more important than the income tax deduction for a contribution of that asset to a private foundation.

For testamentary funding of a charitable entity, the income tax deduction is irrelevant.

b. **Substantiation Requirements**. A frequently arising problem is that since 1993, no income tax charitable deduction is allowed for any contribution of cash or other property valued at $250 or more unless the donor receives "contemporaneous written acknowledgment" from the charity before the earlier of the actual filing date or the due date (including extensions) for filing the return that claims the deduction. §170(f)(8); *see Durden v. Commissioner*, T.C. Memo. 2012-140 (charitable deduction was denied for cash contribution to church because receipt letter did not have the required sentence that the taxpayer did not receive any goods or services and receipt of a proper letter after the taxpayer received the notice of deficiency was not sufficient). This requirement applies even to trust-form private foundations of which the donor is the sole trustee. Every year, the Tax Court must deal with various cases in which knowledgeable planners failed to comply with the substantiation rules, and the judges usually require strict compliance.

There is no similar requirement for the gift or estate tax charitable deduction, but the donor must provide information that may be requested by the IRS. For charitable gifts by S corporations or partnerships, the receipt need only be given to the entity, even though the shareholders/partners may claim the flow-through deductions on their personal returns. Reg. §1.170A-13(f)(15).

c. **Appraisal Requirements.** For a contribution of property valued at more than $5,000, the donor must obtain a "qualified appraisal" of the property valued at more than $5,000 (with some exceptions, discussed below) and attach an "appraisal summary" (Form 8283) to the income tax return claiming a charitable deduction, or else the deduction is disallowed in its entirety. §170(f)(11)(C)-(D). The $5,000 threshold applies on an annual basis for all gifts of the same or "similar" items even if made to different organizations. An appraisal is not required for gifts of cash or publicly traded securities and is not required for non-publicly traded stock if the deduction involved is less than $10,000. Reg. §1.170A-13(c)(2)(ii).

Most of the reported cases have required strict compliance with the appraisal rules, but a few cases have recognized substantial compliance with the rules.

6. Considerations in Selecting a Charitable Donee

a. **General Factors.** Factors to consider in selecting a charitable donee include the following: The donor's relationship to the nonprofit; the availability of investment management; the amount, nature, restrictions, and retained control of potential assets [a potential advantage for private foundations]; the ability [or need] for the donee to raise funds from third parties; the desire for anonymity and privacy; the tax on investment income [applicable to private foundations]; the minimum distribution requirements [applicable to private foundations]; the burden of administration, tax filings, and management costs [a concern in particular for private foundations]; the use of specific planned giving vehicles that could defer funding until death; and grant making considerations, including the nature and location of anticipated grantees, the ability to make scholarship grants to individuals, and the availability of donor input for grants.

b. **New vs. Established Entity**. Questions to consider in selecting between a new and an established entity include the following: Does the donor already have a relationship with an institution related to the desired charitable goal? Is this a scenario that needs a new enterprise? If a separate entity is needed, does the donor have the acumen to manage the investments? Is running an entity where the donor wants to spend energy, or would the donor rather use an entity that has a professional staff? If an existing entity is used, can appropriate guidelines around the use of the donor's money be implemented? Is this an issue that the donor is incubating and can convince others to join? What is the donor's capacity to raise funds (compared to using other established organizations that have funding sources)?

c. **Proliferation of Entities**. The charitable community has experienced a great deal of entity proliferation, with many donors setting up their own foundations. Even if a client should "want my name on something big," the client should understand that ways exist to do that in a more impactful manner than automatically starting a new organization. The reality is that starting a nonprofit organization involves a considerable resource drain. In the case of a new public charitable entity, keep in mind that from the outset, it would be on the tipping point of being a private foundation if it depends largely upon the donor for funding. "Who wants to spend time dealing with the administrative issues and the tipping rules?"

d. **Fiscal Sponsorship**. The use of a "fiscal sponsorship" is a growing trend in the charitable community. It refers to the practice of nonprofit organizations offering their legal and tax-exempt status to groups engaged in activities related to the organization's missions, typically involving a fee-based contractual arrangement between a project and an established nonprofit organization. Using a fiscal sponsorship is a way to launch a movement without having to comply with all the administrative burdens and inefficiencies of operating a §501(c)(3) organization. Fiscal sponsorships can offer improved access to funding, increased credibility, and low-cost financial and administrative services. They enable a program that does not itself qualify as tax-exempt to attract funding that through the fiscal sponsor will be tax-deductible to donors.

   The fiscal sponsor must be careful that it does not merely serve as a conduit for the transmission of deductible donations to entities not qualified to receive them. The

sponsor must assure that the particular project is in furtherance of its exempt charitable purposes and that it is responsible for the operations and activities of the project.

e. **Component Funds of Public Charities**. Supporting specific causes may be possible through a public charity, rather than simply making a contribution to the public charity's general funds. "Component funds" at public charities include unrestricted funds, designated funds, and field of interest funds. A donor advised fund is one of these types of component funds in which the donor has the privilege of making recommendations regarding the use of funds and in some cases the investment of funds.

f. **Donor Advised Funds**. A family that is interested in pursuing a charitable cause may choose to begin with a donor advised fund. Parents may be able to experience whether and how their children can work together, whether they have a real passion for the cause, and what strategic directions they develop. They could govern the fund somewhat like a separate entity (having minutes, meetings, etc.) but enjoy the efficiencies of a donor advised fund.

Items 7-11 are observations from a panel of Prof. Susan Gary and Merry Balson discussing "Getting Organized" about creating a new nonprofit organization (including selecting the type of §501(c)(3) organization, choosing the form of entity, designing effective governance, and securing tax-exempt status).

7. Requirements and Types of §501(c)(3) Organizations

a. **General Requirements.** Section 501(c) lists a wide variety of organizations that are exempt from taxation (except for unrelated business income). Section 501(c)(3) applies to "[c]orporations, and any community chest, fund, or foundation, organized and operated exclusively (interpreted as primarily) for specified exempt purposes, "no part of the net earnings of which inures to the benefit of any private shareholder or individual," and that does not participate in campaigning or (for the time being) have lobbying as a substantial part of its activities.

The two major categories of §501(c)(3) organizations are **public charities** described in §509(a)(1)-(4) (having broad public support and broad oversight) and **private foundations** (*i.e.*, all §501(c)(3) organizations that do not qualify as a public charity; organizations are presumed to be private foundations unless they can establish that they satisfy the requirements of a public charity classification).

b. **Public Charities**. Public charities include:

(i) *per se* public charities (including churches, schools, hospitals and medical research organizations, governmental units, and certain agricultural research organizations, §§509(a)(1), 170(b)(1)(A)(i)-(iv));

(ii) publicly supported organizations (meeting a one-third support test OR a facts and circumstances test;

- The one-third support test "normally" requires at least one-third of total support from governmental units or the general public, Reg. §1.170A-9(f)(2);

- The facts and circumstances test "normally" requires at least 10% public support and having other public features such as a fundraising program, community board, programs available to the public, or varied sources of support, Reg. §1.170 A-9(f)(3);
- For both the one-third support trust and the facts and circumstances test, a cap of 2% per donor applies, Reg. §1.170A-9(f)(6)(i);

(iii) gross receipts organizations, §509(a)(2); and

(iv) supporting organizations (with very technical restrictions), §§509(a)(3) & 170(b)(1)(A)(viii)).

c. **Private Foundations**. Private foundations are generally funded by a few donors and are closely controlled. Types of private foundations include:

(i) private operating foundations that use assets to conduct their own charitable programs rather than making grants to other organizations, §170(b)(1)(A)(vii) and (F)(1) (these are treated as public charities for purposes of the percentage limitations on charitable deductions and are exempt from the annual distribution requirement and net investment income tax);

(ii) pass-through foundations that distribute all receipts annually, §170(b)(1)(A)(vii) and (F)(2);

(iii) private grant-making foundations; and

(v) corporate grant-making foundations.

Private foundations are subject to a draconian system of excise taxes requiring a great deal of client education. These include excise taxes on net investment income of 1-2% (§4940), self-dealing (§4941), the failure to make minimum annual distributions (generally 5% of assets) (§4942), excess business holdings (§4943), jeopardizing investments (§4944), and taxable expenditures (§4945). Private operating foundations are exempt from making minimum annual distributions, and from the net investment income tax.

8. Section 501(c)(4) Organizations

A §501(c)(4) organization is a social welfare organization primarily engaged in promoting the common good and general welfare of people of the community. Unlike 501(c)(3) organizations, they might also participate in political campaigns and elections as long as their primary activity is the promotion of social welfare that is related to the organization's purpose. These are exempt entities, but contributions to them are not tax-deductible by the donors for income or estate tax purposes (but they are deductible for gift tax purposes). Section 501(c)(4) organizations provide much more flexibility. For example, they do not have to disclose their donors publicly (which has led to their extensive use for lobbying purposes) and they are not subject to private foundation restrictions. State income and property tax considerations must be examined.   (Because an estate tax deduction is not available, testamentary funding of a §501(c)(4) organization or retained controls by a donor over a §501(c)(4) organization are problematic for donors subject to estate tax.)

9. Choice of Entity

Nonprofit organizations are typically either nonprofit corporations or trusts. (Other forms are LLCs or unincorporated nonprofit associations, but these are much less common.) Trusts may be easier to form (no state law filing requirements generally apply), but nonprofit corporations are more commonly used than trusts; corporations are easier to modify or terminate than trusts.

While the technical standard of care for liability purposes may typically be stricter for trustees than directors, if a judge wants to find negligence, the judge will find whatever level of negligence that is required.

A hybrid entity is sometimes used—a trust as a single member of a single member nonprofit corporation, but many state attorneys general do not like this hybrid form.

10. Designing Effective Governance

a. **Mechanics of Creation of Entity.** Mechanical issues that must be addressed in creating the entity and formulating governance provisions include:

- prepare organizational documents (e.g., articles of incorporation and bylaws [the articles are similar to those for a regular corporation, but must include some things the IRS requires for tax-exempt entities and private foundations, *e.g.*, documents must prohibit activities that violate the private foundation rules]);
- secure approval for regulated activities (for example, for schools and hospitals);
- file organizing documents with the appropriate state authorities;
- apply for EIN (Form SS-4);
- notify the state attorney general (if required);
- hold organizational meeting (explain documents and restrictions, adopt bylaws, elect board of directors and/or officers, ratify actions of incorporator, authorize reimbursement of organizational expenses, and authorize a specific officer to hire counsel and file Form 1023);
- adopt policies and procedures at the organizational meeting (procedures the IRS likes every entity to include address compensation [considering safe harbors], conflicts of interest, documenting board actions, investment policy, document retention and destruction, transparency and accountability, and whistleblower/ethics; Forms 990 and 1023 ask about some of these policies and procedures; *see* **https://www.irs.gov/pub/irs-tege/governance_practices.pdf**; and
- comply with federal, state and local reporting obligations (e.g., annual reports, state attorney general filings, and charitable solicitation filings).

b. **Other Required Filings**. Other required filings include annual information returns (Form 990/Form 990-PF), unrelated business income tax reporting (Form 990T), employment tax returns, state sales and property tax returns, state charitable solicitation reports, and state annual reports/registration.

11. Securing Tax-Exempt Status

All charitable entities other than *per se* public charities (churches, schools, colleges and universities and a few other types of entities) must file for tax-exempt status using Form 1023 (or Form 1023 EZ for small organizations). The instructions to Form 1023 are an excellent resource. An interactive Form 1023 is available online that is very helpful. Anything attached to the Form 1023 is open for public inspection. *See generally* IRS Publication 557, Tax-Exempt Statute for Your Organization: **http://www.irs.gov/pub/irs-pdf/p557.pdf**.

Items 12-15 are observations from a panel by Jeff Thede, Greg Olson (UBS Private Wealth), and Sue Robinson (KPMG) discussing "Getting Launched: The Operational Challenges."

12. Structural Issues in Designing the Family Foundation for Smooth Operation

a. **Stages of Control and Governance.** Many family foundations move between three distinct stages of control and governance: (a) founder control, (b) collaborative family phase as the founder actively involves other family members, and (c) family-governed but staff-managed phase when responsibilities exceed the board's capacity.

b. **Mission Statement.** Having a clear and concise mission statement is critical to focus grantmaking activities, communicate the foundation's role to the community, and attract potential donors. In designing a mission statement, consider the founder's vision and long-term goals, priorities, geographic scope, grant funding philosophy, types of grants, distribution amounts, and growth plans. Consider the anticipated term of the organization ("perpetual is a long time;" for example, the plan may be to distribute assets to DAFs after the founder dies).

c. **Selecting the Board**. Define the roles and skills needed on the board. In setting the size of the board, consider practicability, expected workload, and a balance of skill sets among the board members. Set terms of office, and clarify succession procedures.

d. **Liability Issues**. Board members/trustees have fiduciary duties (i) to act in the best interest of the corporation or trust: good-faith, care, and loyalty, (ii) to avoid conflicts of interest (stricter requirements for trusts than for corporations), and (iii) to prudently invest assets. Most state laws provide protections except for specified levels of negligence, and also provide mandatory or permissive indemnification rules for acts that are in good faith within the scope of duties of the directors. General liability insurance and personal insurance may also provide liability protection.

   All states have volunteer liability laws generally protecting uncompensated individuals. The federal Volunteer Protection Act of 1997 provides protection for uncompensated directors, officers, trustees, and direct service volunteers who perform services for a §501(c)(3) organization or any organization established for charitable, civic, educational, religious, welfare, or health purposes as long as the actions are within the scope of duty and as long as the any losses are not due to willful or criminal misconduct, gross negligence, reckless misconduct or flagrant indifference. (Directors should carefully consider the protection afforded by these volunteer laws before agreeing to receive any compensation.)

e. **Board Committees**. Examples of board committees include an executive committee, finance committee, grants committee, nominating committee, and investment committee.

f. **Staffing the Foundation**. Determine staff requirements, job descriptions, and salary requirements. Recent statistics on foundation staff salaries are available from the Council on Foundations, the Foundation Center, and the Association of Small Foundations. Family members can receive reasonable compensation from private foundations as long as the salary is paid for personal services that are reasonable and necessary.

g. **Employees**. Nonprofit organizations are subject to state and federal employment laws. Distinguish between employees and independent contractors. Volunteers are not subject to the employment laws applicable to employees. Form 1099-MISC should be filed for consultants or independent contractors paid more than $600 in a fiscal year.

13. Foundation Administration

a. **Record Keeping and Accounting**. Recommended and required records include IRS filings (Form 1023, Form 990-PF, Form 990-T, excise tax estimates, etc.), employee records, financial asset records, accounting for receipts and expenditures for foundation administration, grant records including files on grant seekers, and minutes of board meetings.

b. **Investment Income Taxation**. The tax on investment income for private foundations typically comes as a surprise to the organization. The foundation is subject to a 1% or 2% tax on net investment income, which includes net capital gains. Deductions are allowed for ordinary and necessary expenses paid or incurred for the production or collection of gross investment income or management of property held for income; expenses that have both an investment purpose and a charitable purpose must be allocated between the two and only the investment portion is deductible.

   The tax rate is 2%, but may be lowered to 1% if the foundation's qualifying distributions for the year are at least equal to a prescribed minimum amount (a rather complicated formula amount that is the sum of (a) the assets of the foundation for the tax year multiplied by its average percentage payout for the five preceding taxable years plus (b) 1% of the foundation's net investment income for the tax year) and if the foundation has made the minimum required distributions for each of the preceding five taxable years.

c. **Investment Management**. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) among other things (i) modernizes the rules governing expenditures from endowment funds, both to provide stricter guidelines on spending from endowment funds and to give institutions the ability to cope more easily with fluctuations in the value of the endowment,(ii) updates provisions governing the release and modification of restrictions on charitable funds (including modifications with the consent of the donor), and (iii) spells out factors a charity should consider in making investment decisions, imposing a modern, well accepted, prudence standard

based on the Uniform Prudent Investor Act. Under UPMIFA, the board not only may but must delegate investment responsibility to qualified persons. A duty of diversification applies – "it's all about process."

d. **Investment Policies.** The organization should have a written investment policy statement addressing issues including spending policies, investment objectives, risk tolerance, asset allocation bands, restrictions on the types of equity holdings, alternative investments that could be considered, review cycle, and investment horizon.

e. **Sustainable Investing.** "Sustainable investing" is the current reference to what was previously referred to as "socially responsible investing." The concept of sustainable investing has evolved to the point that it is now considered "modern" investing and has become mainstream. $8.72 trillion of Sustainable and Responsible Investment (SRI) assets represents 21% of the total invested assets in the U.S. market. Under this approach, the investment attractiveness of companies is determined not only by financial data, but also nonfinancial criteria based on various sustainability factors. Sustainability factors that drive market value include brand value, reputation, research and development pipelines, customer satisfaction, health and safety record, environmental performance, social license to operate, and governance issues. Sustainability factors create operating efficiencies, support value creation, and create brand equity. Sustainability does not mean subpar returns; to the contrary, companies with a history of sustainability are more likely to be able to survive a significant risk event.

f. **Ongoing State Filing Requirements**. Incorporated entities must follow state law requirements for annual or periodic registrations including a periodic update of basic contact information, periodic employment forms with the state Department of Labor, periodic renewal of the tax-exempt status (required in some states), and local or state filings that that may be required when the foundation is selling goods or services. The foundation may also need to apply for sales/use or property tax exemptions separately from other corporate registrations.

   State Attorney General Filings. Filings may also be required with the state attorney general. The IRS requires that foundations with assets of $5,000 or more at any time during the taxable year file a copy of the Form 990-PF (and Form 4720, if applicable) with the attorney general of every state in which it reports or is registered, the state in which the principal office is located, and the state in which the foundation was created. In most states the attorney general requires notification if a charity is refused recognition as a tax-exempt organization, loses its exemption, or has a tax deficiency.

   Solicitation Registration. Charitable organizations that solicit funds for charitable purposes are often required to register with a state agency, municipal government, or other local government.

   Financial Reports. Some states require financial reports to be filed periodically.

g. **Form 990**. Public charities with over $5,000 of assets generally must file Form 990 annually, and private foundations file Form 990-PF annually. The Form 990 consists of a 12 page core form and a series of 16 schedules. It requests information about the governing body and management of the organization with respect to various

specific issues, and requests information about the organization's conflict of interest policy and various other policies. It also asks about public disclosures of the Form 990 and various other documents and statements.

14. Private Foundation Restrictions

a. **Generally**. Punitive taxes are imposed on foundations, foundation managers, and "disqualified persons" involved in:

- Self-dealing actions (§4941);
- Failure to make qualifying grants of a minimum amount each year, typically 5% (§4942);
- Excess business holdings (generally more than 20% [less the amount held by disqualified persons] of the voting stock in a corporation holding an active business [or profits interest of a partnership]; the 20% limit is increased to 35% if effective control is not held by disqualified persons; the charity has five years to dispose of excess business holdings acquired by gift or bequest) (§4943);
- "Jeopardy investments" (§4944); and
- "Taxable expenditures," including grants for impermissible purposes (§4945).

Charitable Remainder Trust Application. The self-dealing restrictions apply to CRTs (§4947(a)(2)), but the excess business holdings and jeopardy investment restrictions apply only if the designated income beneficiaries include charitable organizations (§4947(b)(3)).Recent letter rulings state that CRTs are not subject to the private foundation restrictions if no income or gift tax deductions were allowed for contributions to the trust, even if a deduction would have been allowable had it been claimed. PLRs 201713002-003.

Charitable Lead Trust Application. The self-dealing restrictions apply to CLTs, but the excess business holdings and jeopardizing investments restrictions apply only if the present value of the charitable income interest exceeds 60% of the fair market value of the trust assets at creation (§4947(b)(3)).

b. **Self-Dealing.** The most problematic (and most commonly violated) private foundation restriction is the prohibition on self-dealing under §4941. It covers practically any type of transaction between a private foundation and disqualified persons, §4941(d). This *generally* includes sales, leases, loans, compensation payments (but a private foundation may pay reasonable compensation to a disqualified person, §4941(d)(2)(E)), or providing personal services. §4941. The restriction applies regardless of the sufficiency of consideration, and the IRS has no equitable authority to excuse harmless violations.

Disqualified persons are defined in §4946 to include substantial contributors, foundation managers, the owner of more than 20% of an entity that is a substantial contributor, a member of the family of any of the foregoing, and a corporation of which any of the above own more than 35% of the total combined voting power. The penalty for engaging in prohibited self-dealing transactions can be up to 200%.

Potential self-dealing transactions are scary from a planner's standpoint. If uncertainties exist regarding the creation of an exempt organization, the application can be submitted and revised as needed in order for the IRS to grant a favorable ruling. If a transaction arises that might be self-dealing, the taxpayer can submit a ruling request through the normal process, but that is expensive. For smaller transactions, the planner may make its best call and file returns. If the planner is wrong, the taxpayer must pay penalties AND undo the transaction (and undoing the transaction may be *very* difficult). The government could even make a criminal fraud argument against the return preparer. The lack of certainty can be most troubling.

Several exceptions apply.

Compensation. The foundation may pay compensation to disqualified persons for "personal services" that are reasonable and necessary to the charitable function of the foundation and are not "excessive." §4941(d)(2)(E).

Goods, Services, and Facilities. A disqualified person may lease property to the foundation or provide goods, services, and facilities to the foundation *without charge*. §4941(d)(2)(C). A foundation may provide goods, services and facilities to a disqualified person only if it is provided on a basis no more favorable than that on which the foundation deals with the general public.

Estate Exception. The estate administration exception is particularly important. It has been applied very liberally by the IRS, but only applies to transactions with assets in an estate (or revocable trust) that are approved by the probate court and that occur before the estate is terminated for which the estate (or revocable trust) receives fair market value that is at least as liquid as the asset that has been given up (an alternative to the liquidity requirement is that the transaction is done pursuant to a binding option). Under the "estate exception," a transaction relating to a foundation's interest in property held by an estate (or revocable trust becoming irrevocable on the grantor's death) is permissible if:

(1) the personal representative or trustee either has a power of sale, a power to reallocate the property to another beneficiary, or is required to sell under an option that was binding when the estate received the property;

(2) the transaction is approved by the court;

(3) the transaction occurs before the estate is terminated;

(4) the estate receives an amount that equals or exceeds the fair market value of the foundation's interest in the property at the time of the transaction, considering the terms of any outstanding option that applied when the estate received the property; *and*

(5) the transaction either (i) results in the foundation receiving something at least as liquid as what it gave up, (ii) results in the foundation receiving an asset related to its exempt function, *or* (iii) is required under a binding option. Reg. §53.4941(d)-1(b)(3).

One of the substantial advantages of the probate exception is that a purchase for a note may be allowed -- the note is typically at least as liquid as the stock itself (at least if the note is negotiable), and the primary issue is whether the note equals or

exceeds the value of the stock that was purchased. For further discussion about using notes under the estate exception, see Item 81.d of the ACTEC 2015 Annual Meeting Musings found **here** and available at **www.bessemer.com/advisor**.

Corporate Adjustment Exception. Stock redemptions (and other corporate transactions) between a foundation and a corporation that is a disqualified person (generally one that is owned more than 35% by disqualified persons, §4946 (a)(1)(E) & (a)(3)) are permissible if:

(1) the corporation offers to all the shareholders the opportunity to redeem "all the securities of the same class … subject to the same terms and conditions";

(2) the redemption offer constitutes a "bona fide offer" to redeem from all the shareholders; and

(3) the redemption price is "no less than fair market value." §4941(d)(2)(F); Reg. §53.4941(d)-3(d)(1). The IRS has issued various favorable rulings even in situations in which the parties anticipate that only the foundation's interest will be redeemed. *E.g.*, PLRs 200720021, 9338046, 9108030, 9015055.

Cannot Use Promissory Note. Generally speaking, loans from a foundation to a corporate disqualified person are impermissible self-dealing. PLR 9347035 approved a redemption under the corporate adjustment exception with an "installment payment arrangement," but that PLR was revoked in PLR 9731034 ("Subsequent to the issuance of the ruling it was discovered that the ruling was contrary to Example 2 of section 53.4941(d)-3(d)(2) of the … regulations").

Funding Notes from Disqualified Person to a Foundation. Various private letter rulings offer alternatives of using LLCs for funding notes from a disqualified person to a foundation. *E.g.,* Letter Rulings 200635017, 201407023, 201446024. For a discussion of these rulings and planning considerations, see Item 85 of the ACTEC 2015 Annual Meeting Musings found **here** and available at **www.bessemer.com/advisor**.

c. **Excess Business Holdings.** A private foundation can hold only very limited interests in an unrelated business enterprise. For a corporation holding an unrelated active business, the foundation and disqualified persons together generally may not own more than 20% of the voting stock, but this is increased to 35% if a third person has effective control §4943(c)(2)(A)-(B). If all disqualified persons together own no more than 20% of the voting stock, the foundation can own nonvoting stock (in any amount). §4943(c)(2). Similar rules exist for partnerships and LLCs, but a foundation may not hold any business enterprise operated in proprietorship form. A business that derives at least 95% of its gross income from "passive sources" is excepted from these rules. A de minimis exception allows the foundation to hold no more than 2% of the voting stock and not more than 2% in value of all outstanding shares of the business. If a foundation has excess business holdings, there are varying rules as to how long the foundation has to dispose of the interest. For example, if it acquired the interest by gift or bequest, it has five years to dispose of the interest (§4943(c)(6)), and the IRS in its discretion can grant another 5-year extension if the foundation can show that it made diligent efforts to dispose of "an unusually large

gift or bequest or diverse holdings or holdings with a complex corporate structure" but was unable to dispose of the holdings within the initial five-year period except at substantially below fair market value. §4943(c)(7).

Alternatives for avoiding the excess business holdings rule include making a sale of sufficient interests, having the foundation distribute business interests to a public charity, converting a private foundation to a public charity, or arranging sales within the estate administration or corporate redemption exceptions. Another common strategy is to delay funding the foundation, because the 5-year period does not start running until the business asset has been distributed to the foundation. For a foundation created under a will, defer funding the foundation, but the start of the 5-year period begins the earlier of the actual funding date or the reasonable period of administration. For a foundation created under a marital trust, the 5-year period does not begin until after the surviving spouse dies, not at the first spouse's death.

The excess business holdings rules do not generally apply to DAFs and SOs.

d. **Minimum Distributions**. Private foundations must make minimum distributions annually to avoid an excise tax. §4942. The distribution requirement each year is 5% of the average fair market value of its non-charitable use assets (not including cash reserves, assets used by the foundation to carry out its tax-exempt purpose, indebtedness, program related investments, and assets held for future use). The distribution must be made by the end of the following tax year, and any excess may be carried forward for five additional years. Distributions to other private foundations or controlled organizations generally do not count. Furthermore, distributions to non-functionally integrated Type III supporting organizations (or to Type I or Type II supporting organizations if controlled by disqualified persons) do not count. The failure to meet the minimum distribution requirement may subject the foundation to excise tax.

IRS waivers of the excise tax are technically allowed for reasonable cause, but they are difficult to obtain. Foundations should maintain an ongoing, rough estimate of the required distribution amount.

e. **Jeopardy Investments.** Investments that jeopardize the carrying out of the foundation's exempt purpose are subject to an excise tax under §4944. Generally speaking, this means that the managers failed to exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of making the investment. Reg. §53.4944-1(a)(2)(i). No specific investments are treated as jeopardizing investments *per se*. However, various types of investments invite close scrutiny including trading on margin, commodity futures, working interests in oil and gas wells, puts, calls, straddles, warrants, selling short, "junk" bonds, hedge funds, derivatives, etc.

"Program related investments" are not treated as jeopardizing investments. They are investments having a primary purpose to accomplish an exempt purpose if the investments would not have been made except for the relationship between the investments and the accomplishment of these exempt purposes. A program related investment must not have a significant purpose of producing income or the appreciation of property, but an investment that produces significant income or

appreciation is not conclusive evidence that it is not a program related investment. Examples of program related investments are low-interest or interest-free loans to needy students, high-risk investments in nonprofit low-income housing projects, etc.

f. **Taxable Expenditures**. Excise taxes under §4945 discourage private foundations from engaging in legislative and political activities, making grants to individuals without prior approval of the IRS, making grants to organizations (other than public charities) without exercising adequate control and supervision over the use thereof, and providing grants for non-charitable purposes.

15. Unrelated Business Taxable Income

The unrelated business taxable income (UBTI) of exempt organizations is subject to tax under §511. An "unrelated" business is one that is a trade or business, is regularly carried on (which could be annual, this does not have to be daily or monthly), and is not substantially related to the organization's exempt purpose. If an organization has related and unrelated activities, expenses must be allocated between those two categories. The IRS actively monitors expense allocations; the organization should be careful to document the manner in which expense allocations are made. Any new source of revenue must be examined to determine if it is UBTI.

Items 16-19 are observations from a panel by Martin Hall, Michelle A.W. McKinnon, Jeanette Lodwig (Seattle Foundation, Seattle, Washington), and Andrew Schulz (Arabella Advisors, Washington, D.C.) discussing "Confronting the Unexpected and Remaining Relevant in an Ever-Changing World," addressing adapting to change, managing board and staff issues, and addressing financial issues.

16. Changes to Mission

a. **Flexibility from Outset.** When forming the charitable entity and in completing the Form 1023, state a mission that is broad enough to be appropriate for expansion as the charity's mission is broadened in the future.

Work with donors in receiving restricted gifts, to provide flexibility to adjust restrictions. (With a testamentary gifts, however, no interaction with the donor may be possible.)

Beware of using the word "endowment" in fundraising programs, or the gifts may be implicitly restricted.

b. **Changes in Philanthropic Methods**. Community foundations are having to adapt to the emergence of donor advised funds by financial organizations, with very low expense ratios. The philanthropic community is experiencing increased interest in donor advised funds. Impact investments are becoming an emerging trend.

c. **Organizational Changes to Adapt to Changing Mission**. Revisit purpose statements in governing documents. Review restrictions on endowments or other assets in light of the revised mission. Preferably, work with the donor while still alive about making changes.

A changed mission of the organization may require new vision and leadership including new talent on the board and staff. (That kind of change is difficult to work through.)

d. **Modification of Release of Restrictions under UPMIFA**. UPMIFA adopts the concept of "deviation" under state law, with some adaptations. Fund restrictions (i) can be modified by donor consent, as long as assets are still used for a charitable purpose of the organization, or (ii) a court, upon application of the institution and with notification to the state attorney general, may modify the purpose of the fund or restriction on use if the use has become unlawful, impracticable, impossible to achieve, or wasteful.

In addition, a streamlined procedure exists for "small old entities": If a restriction on use is unlawful, impracticable, impossible to achieve, or wasteful, the organization, with 60-days' notice to the state attorney general, may modify the purpose or restriction if the fund has a total value of less than [$25,000] and has been in existence for more than [20] years. (States have enacted varied dollar amounts and the number of years for this exception.)

If a state attorney general is involved, the office may readily agree that the current use or restriction is unworkable, but may disagree on what the new use or purpose should be.

In any event, the organization must use the property in a manner consistent with charitable purposes expressed in the applicable gift agreement.

e. **Actions with Stakeholders**. When undergoing significant mission changes, communicate clearly and consistently with stakeholders about the changes. Strong support from the full board and senior leadership level of the organization is very important. Be prepared to meet with some disapproval; everyone will not be happy with changes, especially if the organization has deep roots in the community.

Communicate closely with staff. Changed mission can be painful; some staff members may realize that they don't fit any longer. For example, switching from grantmaking to impact investing will mean the some staff members who have run the grants program will not have the skill set or will not be needed under the changed vision.

Anticipate board members, community leaders, or supported groups who will have feathers ruffled by the change and reach out to them first. Be proactive in communication rather than allowing them to stew about the change and contact the organization when they are "spitting mad."

The changed mission may result in increased administrative costs (which is historically bad in the charitable world). Explain how the spending plan contributes to the mission. The changed mission may require new expertise with higher salaries.

17. Changes in Tax and Regulatory Environment

a. **General Concern about Impact of Tax Reform**. A great deal of speculation exists about what will happen with tax reform and the impact that may have on the charitable sector. Deductions are referred to as "tax expenditures" for federal revenue purposes. Base broadening and removing preferences that exist under the current system may impact charitable giving.

b. **Major Reform Proposals**. Major reform proposals that could impact charity include (i) former Representative Dave Camp's Tax Reform Act of 2014 (over 1,000 pages with many issues discussed in detail), (ii) GOP House Blueprint for Tax Reform, (iii) Trump administration guidelines for tax reform, and (iv) Charities Helping Americans Regularly Through the Year Act (the "CHARITY Act") introduced by Sen. Thune (in 2016 and again in 2017). These various sources provide ideas that could ultimately be enacted.

The Camp proposal in particular has many detailed provisions in legislative text already and could become the basis of legislation. When tax reform momentum emerges, pressure to draft bill text will increase. This is referred to in legislative circles as "the Christmas Tree": as the working text goes through the halls, every legislator hangs his or her own ornament on the tree. A bill already in text form is more likely to be enacted than theoretical concepts.

c. **Tax Reform Act of 2014 Camp Proposal**. Some of the major changes in the Camp proposal are summarized.

Charitable Deductions.

- Taxpayers could deduct charitable contributions made after the close of the tax year but before the due date of the return (April 15 for individuals). (That change may merely shift the timing of gifts rather than increase charitable giving.)
- Charitable contributions would be deductible only to the extent that they exceed 2% of the donor's adjusted gross income.
- All contributions to public charities (and private operating foundations) whether of cash or appreciated property would be subject to a 40% AGI limitation.
- All contributions to private foundations not qualifying for the 40% limitation would be subject to a 25% AGI limitation.
- The deduction for contributions of appreciated property would be limited to the donor's adjusted basis in the property, but contributions of the following types of property would be deductible at fair market value less any ordinary income that would have been realized had the property been sold – related use tangible personal property, publicly traded stock, qualified conservation contributions, qualified research property, and qualified inventory contributions.

Employee Compensation. A new 25% excise tax would be imposed on charitable organizations that pay more than $1 million to certain "covered employees" (the organization's five highest compensated employees). The tax applies to "remuneration" in excess of $1 million, which includes wages and excess "parachute payments" (but not Roth contributions). This could have a significant impact on health care organizations (or universities with football programs).

Unrelated Business Income Tax. The UBTI tax would be extended in various ways, including UBTI "basketing" (the proposal would treat each separate activity separately, so that net losses of some activities could not offset the income from other activities). In addition, corporate sponsorships would be impacted -- a sponsor's payment will be treated as *per se* UBTI if the sponsor's name or logo is

used, and if the organization receives more than $25,000 of qualified sponsorship payments for any one event, the usual acknowledgment of the sponsor's name or logo must appear with the name of a "significant portion" of the other donors to the event (meaning that football bowl games would no longer carry the name of a single sponsor).

Excess Benefit Transactions. The excess benefit transactions rules would be expanded to apply not only to §501(c)(3) but also to (c)(5) (labor organizations) and (c)(6) (trade associations). The organization itself would be subject to a new 10% tax in addition to the tax currently imposed on the disqualified person and organization managers. The rebuttable presumption of reasonableness would be eliminated along with the ability of directors and officers to rely on professional advice as a safe harbor. "Disqualified persons" would be expanded to include athletic coaches and investment advisors.

Donor Advised Funds. The proposal would require donor advised funds to meet a distribution requirement. They would be required to distribute contributions within five years of the receipt (panelists indicated that proposal has been soundly rejected). Distributions would be restricted to public charities described in §509(a)(1) or (2) and could not be made to supporting organizations, private foundations, or other donor advised funds.

Private Foundations. Self-dealing transactions would subject the organization itself to a 2.5% tax in addition to the taxes currently imposed on the disqualified person and foundation managers. The self-dealing tax imposed on the disqualified person would increase to 10% in cases involving the payment of unreasonable compensation. The safe harbor for foundation managers who rely on professional advice would be eliminated. Private operating foundations would be required to meet the same minimum distribution requirements that apply to private non-operating foundations. The 2% excise tax on net investment income would be reduced to 1%. The tax on net investment income would be imposed on "exempt" operating foundations.

d. **Overview of CHARITIES Act Proposal**. The CHARITIES Act would, among other things:

- apply the IRA charitable rollover rules to distributions to a donor advised fund;
- require that donor advised funds disclose in their returns specified details regarding (i) policies on inactive or dormant funds, and (ii) average aggregate contributions to and grants made from the funds during the most recent 3-year period;
- reduce the excise tax on investment income of private foundations from 2% to 1%;
- require tax-exempt organizations to file their returns in electronic forms and require the IRS to make the returns available to the public in a machine-readable format as soon as practicable; and

- exempt certain philanthropic business holdings from the tax on excess business holdings of private foundations if the foundation meets requirements for exclusive ownership, donating all profits to charity, and independent operation.

e. **Other Changes under Consideration**.

Certain College Endowments. A 1% tax would be imposed on educational organizations that have extremely large endowments (more than $100,000 per enrolled student). "They could just list the six organizations that really want to tax."

Johnson Amendment. The Johnson amendment is a prohibition on §501(c)(3) organizations from participating in or intervening in political campaigns, resulting in a loss of exempt status. Enforcement of this provision has been very spotty. The provision is vague and unclear as to what is covered. (A recent survey said that 80% of religious congregations do not want the Johnson amendment repealed; they fear that religious organizations involved in politics will end up with fractured congregations.)

f. **Accounting Changes**. The FASB on August 18, 2016 released ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, which will be effective for annual financial statements for fiscal years beginning after 2017. The 280-page guidance provides significant changes for financial statement presentations for nonprofit organizations. "CPAs don't yet realize how much work this will be in order to make the new disclosures," but the disclosures will be helpful to boards in overseeing and planning the organization's activities. The changes include the following.

- **Net Asset Classification and Disclosures**. Financial statements will present two net asset classes (net assets with donor restrictions and net assets without donor restrictions) rather than three net asset classes used currently (unrestricted, temporarily restricted, and permanently restricted). The distinction between temporarily and permanently restricted has been blurred due to state law changes and the adoption of UPMIFA. The reduction will reduce the complexity and enhance the understandability of financial statements. Donor restrictions will be the only factor in determining how the assets are classified, not restrictions imposed by the management or board. (Board-designated endowments will be classified as net assets without donor restrictions.)

  The various types of donor-imposed restrictions will also have to be disclosed. Examples include restrictions for supporting a particular activity, an investment for a specified term, use in a specified period, or the acquisition of long-lived assets. In addition, the statement must disclose information about the nature of restrictions that impact how, and when, if ever, donor-restricted assets can be used.

  Additional guidance is provided regarding the reporting of all endowment funds including detailed information required regarding underwater donor-restricted endowments.

- **Reporting of Expenses and Investment Returns**. Functional expenses must be broken down by function (expenses attributable to each separate major class of program services) and by their nature (such as salaries, rent, supplies, and

depreciation). Investment expenses are not included in this expense analysis. Investment returns will be reported net of related investment expenses, providing a more comparable measure of investment returns regardless whether the investments are managed by internal staff or outside investment managers. Direct internal investment expenses will be netted against investment returns (rather than being reported elsewhere) only if they directly contribute to generating investment returns.

- **Liquidity and Availability of Resources.** New disclosures will be required regarding the liquidity and availability of resources for meeting cash needs for general expenditures within one year, information about restrictions on the availability of financial assets due to their nature, external limits imposed on assets, and internal limitations.

18. Managing Board and Staff Issues

a. **Preemptive Board Actions**. Preemptive actions for the board include (i) making sure that bylaws are appropriate for the activities of the organization and consistent with applicable state laws, (ii) adopting appropriate policies, including a conflicts of interest policy, a whistleblower policy, and a compensation policy, and (iii) operating in compliance with the bylaws and policies (or modifying them as appropriate).

Directors have a duty to be informed. Look outside normal channels to learn of developments that might impact the organization. When boards fail, the typical cause is just following staff who caused the problem in the first place. For example, board members may be the first to notice possible changing tax laws that may impact the organization.

b. **Common Board Issues**. Common board potential problems include board apathy and boredom, control by a dominant director, behind-the-scenes decision-making, micromanagement of organization and staff, lack of strategic planning and directions to the staff, unwillingness to confront problems, and limiting the board's activities to fiduciary governance rather than generative governance.

c. **Board Rejuvenation**. Rejuvenating the board takes particular focus. Emphasize strategic planning for greater education about mission and community needs. Select new board members with appropriate expertise and consider including diverse or younger directors while eliminating inactive or difficult board members. Set expectations when a new member joins the board. Some organizations use an annual commitment form stating the expectations of board members. Develop a culture of board members not automatically being renewed at the end of their terms of service.

d. **Common Staff Issues.** Common staff issues include ineffective leadership and loss of staff morale, lack of skills, unwillingness or inability to grow and change with the organization, failure to keep the board informed and to address problems timely, and failure to follow the direction of the board.

e. **Staff Management**. Provide clear job descriptions and expectations, updating as appropriate. Conduct annual or more frequent reviews. Reevaluate staffing needs as the mission and activities of the organization change. Obtain legal advice before terminating staff members. Adopt and comply with an employee handbook and policies.

19. Managing Financial Distress

For financial distress due to **declining support** from the public and through grants, consider other sources of support, consider adjusting the mission, appoint board members with the ability to attract support, and determine the effect of the declining public support, if any, on tax classification as a public charity.

For financial distress due to **poor investment performance**, review the investment policies, monitor the performance of investment managers, consider other sources of support that may be available during an economic downturn, and consider reducing expenses.

For managing financial distress due to **unexpected expenses**, establish a rainy day fund to cover six months of operations, consider insurance to cover unexpected expenses (such as property insurance, general liability insurance, libel and slander insurance, cyber insurance, director and officer liability insurance, and employment practices liability insurance), and seek support to cover unexpected expenses.

For **financial management**, seek competent third-party advice and guidance, use conservative budgets, cut costs where possible but aim to avoid a reduction in services or charitable expenditures if possible.

If a **misappropriation of funds** occurs, determine whether recovery of funds is possible, contact law enforcement (boards are usually reluctant to do so), seek legal guidance and terminate employment as appropriate, and determine whether any self-dealing or excess benefit transactions must be reported for tax purposes.

Items 20-23 are observations from a panel by Edward Jay Beckwith, Prof. Susan N. Gary, Martin Hall, and Michelle A.W. McKinnon, discussing "Leaving a Legacy with Grace and Dignity."

20. Restricted Gifts

Gift restrictions can result in unreasonably hamstringing the organization from being able to adapt to changes to assure the continued viability of the organization.

a. **Source of Restrictions**. Restrictions may appear in the organizational documents (in the articles of incorporation and bylaws for corporation or trust agreement for a trust), or in the gift agreement (which, under UPMIFA, includes any writing [including electronic] or solicitation materials). Board-designated endowments are not restricted, but if a donor contributes to an endowment created by the board, the donor's gift is restricted.

b. **Changing Organization's Purpose or Mission**. Nonprofit organizations have the ability to change their mission and purpose by amending the articles or bylaws, but may not be able to divert donations already received to a new purpose. Trust organizations will require a reservation in the trust agreement to make modifications by donor consent or judicial action. Donors expect organizations to continue with their stated purpose; plan for flexibility but be sensitive to protecting donors' intentions in making contributions to the organization.

c. **Modification of Restrictions**.

- **Donor Consent**. Restrictions can be modified with donor consent, but the donor may be deceased, or there may be too many donors to obtain consents of all donors.
- **Deviation**. The trust doctrine of deviation has been incorporated in UPMIFA (with some minor differences). UPMIFA describes the deviation concept as follows:

  > The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. The institution shall notify the [Attorney General] of the application, and the [Attorney General] must be given an opportunity to be heard. To the extent practicable, any modification must be made in accordance with the donor's probable intention. UPMIFA §6(b).

  For example, the Barnes Foundation Museum was moved from its original location to Philadelphia under this approach. Satisfying the deviation modification requirements is easier than satisfying the cy pres requirements (described immediately below).
- **Cy Pres**. UPMIFA describes the cy pres approach for modifying restrictions as follows:

  > If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful, the court, upon application of an institution, may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument. The institution shall notify the [Attorney General] of the application, and the [Attorney General] must be given an opportunity to be heard. UPMIFA §6(c).
- **Relaxed Procedure For "Small Old Funds."** UPMIFA allows the modification of a restriction that is unlawful, impracticable, impossible to achieve, or wasteful, as long as the fund is less than $25,000 and has been held more than 20 years (some states have changed that maximum dollar amount and minimum time frame) by giving 60 days (some states have changed the number of days) notification to the state attorney general, without court action, as long as the institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument. UPMIFA §6(d).

d. **Drafting Issues Regarding Restrictions**. Provide a clear statement of intent regarding any restrictions. (How restrictive? Provide for flexibility? Address future changes? Give someone the power to change the restriction – but who?) Significant litigation regarding a change from the donor's intent has emerged in recent years. Donors should understand that gift restrictions may cause charities to spend substantial expenses for deviation or cy pres in order to adjust to changing circumstances. One alternative is to provide a statement of intent, but provide substitute purposes as guidance to the organization.

Consider reserving standing for enforcement of the restriction (donor only or also descendants?). Traditional law is that the state attorney general has standing but not the donor to enforce gift restrictions. Lawyers are now routinely drafting standing provisions in restricted gift agreements. In some situations, a significant restriction in connection with a standing provision may cause a charity to refuse the gift.

The gift agreement may provide a contingent remainder. The donor will need to decide upon a successor charity and whether any reporting requirements will apply. An effort to enforce a restriction by such a contingent beneficiary may be awkward at best.

21. Fraud Issues

a. **Particular Concerns for Charities**. Charitable boards must be sensitive to fraud prevention. A variety of factors lead to particular susceptibility for charities: informality of operation, lack of knowledge and awareness of fraud concerns, undue levels of trust by board members, unwillingness to discuss fraud risks, complex revenue streams, and high susceptibility of the charity and board members to negative publicity. The IRS does not have sufficient resources to enforce gift restrictions, and attorney generals are not active in most states in overseeing charitable organizations.

b. **Typical Fraud Issues for Charities**. The types of fraud experienced by charities include the following:

- Skimming;
- Purchasing fraud, fabricating expenses (the most common and easily perpetrated fraud); and
- Financial reporting fraud (the cover-up to protect the board from public disclosure; expenses may be classified incorrectly to reduce reported overhead expenses, or the value of donated goods and services may be inflated).

c. **Financial Controls.** Financial controls should be implemented to reduce the opportunity for fraudulent activities.

- The board should oversee that complete, current, and accurate records are maintained and review financial statements at least quarterly.
- Review current performance with prior years, and focus on things that look different.
- An independent audit should be conducted annually, and the audit committee should meet with the auditors independent of any staff.
- Internal control policies should ensure that no one person has the sole authority for receiving, depositing, and spending funds. At each step of handling funds, more than one person should verify the activity.
- An investment policy should be established for cash reserves or endowments.
- No loans to directors, officers, or trustees should be permitted.
- Expense reimbursements should require clear explanations, and no expenses of family members should be permitted unless they are involved directly in the activities of the organization.

22. Bankruptcy

a. **Overview**. If the board thinks that a bankruptcy might be involved for the charity, the board should solicit advice from a good bankruptcy lawyer who has experience with charitable organization bankruptcies. A bankruptcy by a nonprofit organization will be a voluntary decision of the organization; a creditor may not put a nonprofit organization into bankruptcy. The traditional bankruptcy alternatives are available; the primary ones are Chapter 7 (going out of business), or Chapter 11 (reorganization).

b. **Charitable Trust Doctrine—Restricted Endowments Not Part of Bankruptcy Estate**. A critical distinctive feature of the bankruptcy of charities is that "charitable trusts" or restricted endowments are not property of the bankruptcy estate. Creditors may access a donor-restricted fund only when the organization has the right to revoke the endowment, an endowment fund is created on the eve of bankruptcy, an endowment fund has historically been used for general obligations of the organization's operations, or the organization has invaded principal in order to fund general operations. The "charitable trust doctrine" excludes restricted assets from the bankruptcy estate, but assets are not restricted if they can be used at any time, in any manner, and for any of the charitable purposes of the organization. *See* Bankruptcy Code §§541(c)(2), 541(d).

   These doctrines provide significant asset protection for endowments restricted for specific purposes or uses. Courts examine each gift individually to determine the donor's intent. An implied or constructive charitable trust can arise if property is contributed to a charitable organization that is directed by the terms of the gift to devote the property to one or more specified purposes for which it is organized.

   Income from a restricted endowment fund is protected only to the extent that income from the fund is specifically subject to conditions on use. If the income is not subject to any restriction and may be used for his general purposes, the income can be used for the payment of debts.

23. Happier Ending—Alternatives for an Organization That Will Cease to Operate

a. **Overview**. Alternatives exist for terminating a charitable entity and preserving assets and programs for further charitable use. Some charities simply run their natural course. Others run into challenges that cannot be overcome. In either circumstance, good leadership and good stewardship can improve the chances for a soft landing so long as applicable legal standards are observed.

b. **State Rules on Termination of a Charity.** While the rules vary from state to state, a nonprofit corporation generally terminates under the same rules generally applicable to corporations, but also requiring notification to the state attorney general, and that assets remaining after paying creditors must be delivered to another charity and "remain in the charitable stream."

c. **Termination Tax for Private Foundations**. Section 507 provides for a punitive tax that seems draconian when a foundation terminates, but the tax ends up applying rarely. Section 507 is ambiguous with little details. Revenue Rulings 2002-28 and 2003-13 provide helpful details, illustrating why the tax rarely applies. For example,

contributions to another §501(c)(3) organization or another private foundation may eliminate the tax. This exception would apply even if the distribution is made to a donor advised fund of a public charity in which the advisor is a disqualified person.

d. **Distribution to Donor Advised Fund.** The organization may distribute its assets to a donor advised fund sponsored by another public charity. This is not unusual for families who become disenchanted with the complexities of operating and maintaining a private foundation. While the private foundation may have paid reasonable compensation to family members, the sponsoring organization will almost certainly not be willing to pay compensation from a donor advised fund (for fear that doing so would violate the excess benefit rules).

e. **Merger**. A charitable corporation may merge with another charitable corporation by following the general state law procedures for merging corporations. Attorney general approval may be required. Merging with another organization may end up being the best way to carry out the founder's charitable vision.

Items 24-38 are selected comments from seminars addressing Cultural Variables in the Estate Planning Relationship.

Items 24-28 are observations from a panel by Sarah Roubidoux Lawson, Jason S. Ornduff, and Stacy E. Singer, discussing "Religious Considerations in Property and Inheritance Rights in Estate Planning."

24. Significance of Religious Considerations in Estate Planning

When working a client with strong religious beliefs, especially if the client has a different faith than the attorney, the estate planning attorney does a greater service to the client by having an understanding of how elements of that faith system may impact the estate planning process.

A 2014 survey indicates that about 79% of American identify themselves with a religion. By far most of these are Christian, but others include Jewish, Muslim, Buddhist, and Hindu.

In client conferences, be sensitive to code words. Instead of asking "how important is religion in your life," pay attention to things like where the children attend school (religious schools?), charitable giving patterns, etc. If religion appears to be important to the client, explore whether the client wants to include anything in the estate planning documents relevant to the client's religious beliefs. This may take the form of a "Statement of Wishes," in which the client can expresses important elements of his or her belief system that the client wishes to leave as a legacy to family members.

Ethical Wills have been discussed as a "gift of spiritual health." DR. ANDREW WEIL, HEALTHY AGING: A LIFELONG GUIDE TO YOUR PHYSICAL AND SPIRITUAL WELL-BEING (Anchor 2007). The purpose of an ethical will is to link a person to both their family and cultural history, clarify their ethical and spiritual values, and communicate a legacy to future generations.

Addressing religious issues with respect to the disposition of assets may be particularly important to orthodox Jews or Muslims (discussed below). Clients having a faith other than Christian **really** need to do estate planning, because intestate succession under state laws may be contrary to their religious dictates.

25. Selection of Fiduciaries

The selection of fiduciaries, especially the selection of guardians, may be very sensitive for the religious client, who may want to select persons who share the same values and beliefs. These include not only guardians and trustees, but also agents under a power of attorney and health care directive. Most religious individuals may want to raise their children in the same faith tradition they practice. The selection of guardian can be extremely sensitive if the spouses do not share the same faith. "A practitioner is cautioned to mention the [guardianship] issue, but for the most part let the parents answer. This is a very sensitive subject for clients, and one in which intrusion by the practitioner can lead to disaster."

26. Specific Drafting Issues—Christian Clients

Christian religious teaching and tradition do not foster a specific set of rules for inheritance or investment of an inheritance. The primary issue the practitioner can point out for many Christian clients is the possibility of the client preparing a "Statement of Wishes" in which the client can express strongly held beliefs to leave as a legacy. Provide that the Statement is non-binding (or else the client becomes the draftsman of the estate plan).

Mormons have a tradition of young single men serving a year of two in mission work. The family is expected to support the family member during this mission service. The estate planning document may instruct the trustee to financially support a child who may choose to go on mission after his or her parents are deceased.

27. Specific Drafting Issues—Jewish Clients

a. **Prevalence in U.S.** A 2013 survey reflects that about one-third of U.S. Jews identify with the Reform movement, about 18% with conservative Judaism, 10% with Orthodox Judaism, and 5% with a variety of smaller groups. About one-third of U.S. Jews do not identify with any particular Jewish denomination.

b. **Separate Jewish Movements**. Orthodox Judaism has the strictest approach to issues, and Reform Judaism has the greatest flexibility, with far fewer absolutes. Orthodox Jews have a strict set of principles regarding who can receive assets from a decedent's estate. However, most American Jews will not feel constrained by these restrictions.

c. **Sacred Writings**. Jewish law is located in the Torah (also known as the Old Testament) and the Talmud (a compilation of rabbinical opinions written over 2,000 years ago).

d. **Inheritance Limitations under Halachah**. "Halachah" places some restrictions on Jewish testamentary freedom, requiring assets to pass to specified closest relatives. A distribution to anyone not designated for inheritance by halachah is deemed invalid. Therefore, a halachic heir cannot be disinherited, even though the Will that disinherits him would still be valid. The halachic rules no not apply to jointly owned assets, including joint tenancy property.

The starting point for the halachic rules can be found in Numbers 27: 5-11 of the Torah. Sons are halachic heirs, while daughters are only entitled to certain levels of support (food, shelter, clothing, medical care and cost of living), and to payment of the expenses of their weddings (unless no sons or descendants of sons survive, in which event the assets pass to the daughters).

Inheritance is based on order of priority; the survivor with the highest priority (or that person's descendants in accordance with halachah) receives the entire estate. The priority for halachic inheritance is generally as follows: (i) Husband, (ii) Sons (first born receives a double portion) or their descendants, (iii) Daughters and their descendants); (iv) Father, (v) Paternal brothers, (vi) Paternal sisters, (vii) Paternal grandfather, (vii) Paternal uncles, (viii) Paternal aunts, etc. The wife is not included in this list, and she inherits no assets but is entitled to either (i) a fixed amount established by a premarital agreement, or (ii) to be supported by her husband's estate until she remarries (food, clothing, medical care and living expenses). Under one interpretation of Jewish law, the surviving widow has a claim against most of the assets (to maintain her standard of living) but has no ability to gift assets or otherwise direct their disposition.

Jewish law assumes that all assets are held in the husband's name, and the inheritance rules from a women are not as clear as the detailed rules listed above. In order for wife's assets to pass other than what is described by halachah, the husband must consent.

Because most Jews want to leave assets in a way that may differ from halachah (particularly the requirements that the oldest son receive a double share, no funds pass to the wife, and no funds are left to a daughter if there is also a son), Jewish scholars have determined various ways to comply with halachah while leaving assets to individuals who would not otherwise be entitled to them. The most commonly used approach is through use of a financial penalty, known in Hebrew as a Conditional Shetar Chov. It acts somewhat like a Jewish *in terrorem* clause. The testator prepares a plan that complies with his testamentary wishes. The testator also creates a conditional debt to the beneficiaries named in the will in an amount that exceeds the estate assets, payable a moment before death. At the testator's death, the halachic heirs have a choice: (i) comply with the terms of the will (which would then void the debt by its terms), or (ii) demand that assets be distributed in accordance with halachah, but the debt must first be satisfied (leaving no assets available for distribution to halachic heirs).

Most Orthodox Jewish scholars recommend that the estate plan includes some specific amount (say $1,000) to be distributed under traditional Halachic rules of inheritance). The following is an example of a short clause employing this approach to be added to the will (observe that this form uses the term "halakhah" rather than the more commonly used spelling, "halachah").

> It is my intent that all transfers of property made under this Will shall be in conformity with Orthodox Jewish law (halakhah). Therefore, for the sole purpose of meeting this objective, I provide as follows:

> 1. I hereby devise and bequeath the sum of One Thousand Dollars ($1,000) to my heirs, as defined in accordance with halakhah, to be divided among them in strict accordance with halakhah.
>
> 2. Each and every distribution or other transfer of any property under this Will, except for the bequest set forth in subsection 1., above, shall be deemed to be made by way of gift, effective the instant prior to my death. Each such transfer shall be deemed to have been completed through a proper kinyan, as appropriate for each type property, and as defined by halakhah.

This clause is from an article by Rabbi Aryeh Weil and Martin Shenkman, *Wills: Halakhah and Inheritance,* Beth Din of American Halachic Will Materials 6 (2008), available at **www.bethdin.org** (and other halachic will materials and forms are available at that website). The article also suggests a form for a separate contractual document (shetar) which creates a fictional debt (a chov), entitled "Conditional Shetar Chov." The article describes the purposes of these provisions as follows:

> Two steps can be taken to minimize this risk. First, some of the language used in the contractual arrangements creating the debt should be the appropriate Hebrew terms, so as to distinguish the document from what may be considered a shetar chov under civil law. Secondly, there does not seem to be any delivery requirements under Jewish law to make the shetar chov valid under religious law. As a result, only a single executed copy of the shetar chov should be prepared. This copy should be held in safekeeping by your Rabbi. This alone should serve as a substantial safeguard to avoid unintended problems.
>
> As a final step in addressing the compliance with the Biblical laws of inheritance, it is suggested that an additional paragraph be added to your secular will. This additional provision has two purposes. The first is to provide for some amount of money which should be distributed in accordance with Jewish law. This will serve to remind your heirs of the rules and customs involved and thus encourage them to take similar steps to make their estate plans conform to Jewish law. The second objective of this additional provision is to provide language which would make the distributions called for under even your secular will come closer to compliance with the Biblical requirements of inheritance. As discussed above, everyone is free to complete inter-vivos gifts. Thus, all transfers under the will could be stated to have been effected by gift transfers, effective one minute prior to your death, and in accordance with the completion of a proper kinyan as required by Jewish law. This language should provide some basis for a Rabbinic Court (Beit Din) to sanction the distributions under your secular will on the basis of your conformity with local custom and certain minority Rabbinic opinions concerning inheritance.

The ACTEC seminar written materials include other more detailed clauses using the conditional debt approach.

e. **Investment Issues**. Judaism does not have rules against charging interest (and historically, Jews were money lenders). Judaism does have a concept that debts would be forgiven after a certain period of time. No particular investment restriction issues arise in estate planning for Jewish clients.

28. Specific Drafting Issues—Islam

a. **Sunni or Shia**. About 85-90 percent of Muslims are Sunni and balance are Shia (predominantly in Iran and a few other countries). Differences between the two can be significant in the estate planning context. For example, the inheritance priority order varies for Sunnis and Shiites.

b. **Sacred Writings.** The main sacred writings of Islam are the Qur'an (the revealed word of God – Allah – through the Angel Gabriel to the Prophet Muhammad, and the Sunna (statements, utterances and actions of Muhammad). The Qur'an and Sunna establish an entire legal code, called Sharia.

c. **Inheritance Issues**. The Qur'an emphasizes the duty of every Muslim with property to provide for its proper disposition at his or her death.

General principles are: (i) one-third can be left to anyone the decedent desires (this is called the wasiyya bequest; (ii) The disposition of the other two-thirds is determined based on family relationships (with differences for Sunnis and Shiites); and (iii) inheritance rights are more restrictive for women than men, but Islam actually improved the legal status of women.

The order of priority based on family relationships is rather complicated. Several highlights are described below.

- **Wives**. Provisions are included for wives. If a husband dies childless, one-fourth of the husband's estate passes to the wife, and if the husband had children, one-eighth passes to the wife. That is a minimum, not a maximum portion that can pass to the wife, though limitations may exist based on obligations to other family members.
- **Sons and Daughters**. Sons inherit twice as much as daughters, but as with wives, daughters are not cut out totally.
- **Inheritance to or from a Non-Muslim**. The majority view is that a Muslim cannot inherit from or give to a non-Muslim, but a Muslim can inherit from an apostate (former Muslim). (A Muslim can, however, make gifts to a non-Muslim in the discretionary one-third portion.)
- **Illegitimate and Adopted Children**. Only legitimate relatives with a blood relationship are entitled to inherit under Islamic law. Illegitimate and adopted children do not inherit. Furthermore, adoption of a child by another does not cut off that child's inheritance right from his birth family.

Example: Husband dies survived by wife, son, daughter and three sisters who survive him. Husband does not exercise the right to make a wasiyya bequest (no discretionary one-third). Wife gets one-eighth, and son and daughter split the rest. Sisters are excluded. Son gets two-thirds of the remainder (after debts and the one-eighth going to wife), and daughter gets one-third of the remainder.

d. **Living Trusts**. Planning with living trusts may be a way for the client to leave property in a manner inconsistent with these rules. Islamic law has no concept of beneficiary designations, pay-on-death clauses, or rights of surviving joint tenants, and that kind of property will be treated as part of the total estate subject to inheritance rules. There are no rules on living trusts as well, but if treated like will substitutes, they seemingly can be used to meet a Muslim client's wishes in connection with the Islamic inheritance rules. Alternatively, gifts could be made during life.

e. **Rights of Women during Marriage**. Six major principles apply to the property rights of wives. (The following is verbatim from the written materials for this panel.)

(1) Before marriage, any gift given by the woman's fiancé to her is her own property, and her husband has no legal right on it even after marriage.

(2) Upon marriage a woman is entitled to receive a marriage gift (Mohr), and this is her own property.

(3) Even if the wife is rich, the full responsibility for her upkeep and that of the household is her husband's responsibility.

(4) Any income the wife earns through investment or working stays as her separate property, and it is not required for upkeep of the household.

(5) In case of divorce, if any deferred part of the Mohr is left unpaid, it becomes due immediately.

(6) The divorced woman is entitled to get maintenance from her husband during her waiting period (iddat).

In modern times, these issues are less set in stone. For example, if both spouses of a Muslim couple are working, both tend to contribute to the household, and both are co-obligated for taxes, expenses of children and the like per state and federal law.

e. **Investment Issues**. Key tenants of Sharia may impact investment issues in the estate plan, especially regarding a fiduciary's duty to invest in accordance with the prudent investor standard. These include:

(i) a prohibition on riba (earning interest);

(ii) a prohibition from investing in assets that are haram (prohibited, including companies involved in gambling, pornography, manufacturing or selling alcohol, financial services [because of the charging of interest as a primary source of revenue], pork products, and [for most scholars], tobacco products); and

(iii) a prohibition on gharar (excessive risk taking, including contractual provisions based on events outside the control of the parties, such as derivatives, futures, options and transactions based on the life of an individual).

Of these, the riba prohibition is the most impactful for many clients. Various estate planning alternatives deal with lending and the payment of interest (e.g., sale transactions for a note with interest at the AFR). Various approaches can be used to avoid the need for formal (prohibited) lending. These require special transactions involving a bank, and the key to using these techniques is to work with a bank that specializes in Sharia lending (for example, a bank in Chicago does that). One of these approaches involves the bank purchasing the item for which a loan is needed (such as a car) and then leasing it to the individual, structured as a lease or lease buyback. Another approach is for the bank to purchase the item (often a home or commercial real estate) and then sell it to the individual in installments at a higher price that reflects a profit margin (but without interest). Another possible approach is to enter into a joint venture to purchase the item, with each party sharing the profit and losses. Some controversy exists within the Islamic community regarding these techniques, and a final decision can be made by a Sharia board. Problems with

getting approval by a Sharia board include that finding three Imams to sit on the board can be difficult, and Sharia boards are not bound by precedent and how they will decide in any given situation can be very uncertain (which makes planning difficult).

Numerous investment funds exist that will comply with the haram and gharar prohibitions. The "Amana Funds" website describes investment opportunities that these funds seek to avoid (such as bonds, stocks of companies with high debt or in industries that do not comply with Islamic principles, or mutual funds or hedge funds that trade securities frequently [which is viewed as gambling by some Islamic scholars]). A Standard & Poor's 500 Sharia Index (launched in 2013) provides a benchmark for the performance of Sharia-compliant funds.

Trusts for Muslims who want to observe these rules should include specific provisions waiving the prudent investor rule, making clear that the settlor understands that returns will be lower than with other available investments, releasing the trustee for making compliant investments, and explaining general rules about Sharia compliant investments. Some estate planning techniques are impossible, such as sales, loans, arrangements that depend on how long some individual lives (GRATs, QPRTs, and CLATs or CRTs with payments for the life of an individual). As previously mentioned, a possible solution is to seek approval from a Sharia board, but that is very unpredictable.

Items 29-33 are observations from a panel by Wendy Goffe, Aubrey Lawlor (College of Nursing, Seattle University), and Akane R. Suzuki, discussing "Cultural Competency in Healthcare and End of Life Decision-Making." (Much of the commentary about cultural competency and end-of-life decision-making is verbatim from excellent materials by Wendy Goffe.)

29. Cultural Competency

Culture is a combination of a body of knowledge, belief, and behavior. Culture refers not only to a person's superficial physical features, but to a person's identity, language, thoughts, communications, actions, customs, beliefs, values and institutions that may be specific to ethnic, racial, religious, geographic or social groups. A continuum of the process for increasing sensitivities to cultural issues has been described as cultural awareness, cultural knowledge, cultural sensitivity, with a goal of cultural competence. The National Center for Cultural Competence states that cultural competence in a law practice is demonstrated by understanding and responding to a client's preferred choices, not by being culturally blind. Attorneys should be mindful of cultural influences and understand the needs and wishes of each client and how those needs and wishes are influenced by the client's culture.

30. End-of-Life Decision-Making

The concept of health care directives (or "living wills") began in the 1970s. One of the earliest advance directive statements was written by Sissela Bok, a philosopher and Harvard professor, in 1976. (It is still a useful document, in spite of all of the changes in thinking about end-of-life decision-making in the intervening 40 years.) The first statutory form was adopted by California in 1976. Following various Acts adopted by the Uniform Law Commissioners dealing with health care issues, the Uniform Health-Care Decisions Act adopted in 1993 has served as the basis for health care directives in all of the states.

The Vermont statutory form (titled "Vermont Living Will") is four paragraphs that are free of legalese. It includes the following simple language:

> If the situation should arise in which I am in a terminal state and there is no reasonable expectation of my recovery, I direct that I be allowed to die a natural death and that my life not be prolonged by extraordinary measures. I do, however, ask that medication be mercifully administered to me to alleviate suffering even though this may shorten my remaining life.
>
> This statement is made after careful consideration and is in accordance with my strong convictions and beliefs. I want the wishes and directions here expressed carried out to the extent permitted by law. Insofar as they are not legally enforceable, I hope that those to whom this will is addressed will regard themselves as morally bound by these provisions.

Five Wishes is a document that is accepted as a valid health care directive in a number of states. It is an amalgamation of a very detailed health care directive, durable power of attorney for health care decisions, POLST and ethical will. It allows the individual to describe what quality of life he or she would like at the end of life, including massage and other ways of making the patient more comfortable. *See* **www.agingwithdignity.org/five-wishes.php** for a customizable form and a list of states where the form meets the state's requirements for a health care directive.

31. Impact of Religious Beliefs on Health Care Decisions

Religious beliefs can have an impact on end-of-life decision making. Some religious traditions advocate an uncompromising commitment to the preservation of human life under virtually all circumstances, and other religious traditions emphasize the right to die with dignity and allow patients and families to participate in deciding when quality of life is so diminished that it justifies withholding or termination of medical life-support. Most faiths favor palliative care that may, as a result, shorten a patient's life span in the process of controlling pain, in lieu of active euthanasia.

To the extent permitted by statutory provisions, advance directives can be modified to express religious beliefs. A simple example is:

> As part of informing my agent herein regarding making decisions as to the application or withholding (or termination) of certain life-prolonging procedures, I direct that my agent may consider any particular religious directions or doctrines that my agent knows to have been important to me. Further, I authorize my agent to consider the financial and tax consequences of such life-prolonging decisions and to take into account my general preference for reasonable measures to be taken to preserve my wealth and reduce taxes for myself and my family. In addition, I also direct my agent to consider taking measures to maximize comfort and minimize suffering based on whatever my condition may be. Unless the financial or tax consequences are materially and consequentially different, my agent should be guided by the principle of increasing comfort and reducing suffering where possible. Jeff Baskies & George Luck, *Taking a Closer Look at Our Living Wills and Advance Directives*, STEVE LEIMBERG EST. PLAN. NEWSLETTER #1913 (Jan. 4, 2012), **www.leimbergservices.com**.

The following discusses the impact of religious beliefs in particular religions on health care issues, but beliefs can vary among individuals within a particular religion. (One panelist quipped, "If you have two Jews, you have three opinions.")

a. **Judaism**. Most health issues for Orthodox Jews arise from questions caused by new technologies, which have been addressed by contemporary rabbinic scholars (none of whom are definitive). Conservative Jews consider Jewish law to be binding, but are also willing to adapt those laws to modern needs. Reform and Reconstructionist Judaism do not consider Jewish law to be binding but the law and ritual is a resource and a guide for moral decision-making and a healthy lifestyle.

   Under Orthodox Judaism, quality of life can never justify a decision to shorten life. So great is the value of life that in some instances a patient can be encouraged, convinced, or even forced to accept medical treatment. Nevertheless, Judaism attempts to strike a balance between the strong interest in prolonging life and recognition that life may become unbearable. When a patient experiences great pain and suffering, medications that merely prolong the life of suffering may be refused. Even praying for someone in such pain to die in order to end the suffering is permitted. In drafting a directive for health care, great care must be exercised in making general statements concerning withdrawal or non-provision of nutrition and hydration.

b. **Orthodox Christian Churches**. In Orthodox Christian Churches, the expressions of a patient in an advance directive are to be considered along with the opinions of the medical professionals involved, family, and one's priest. An Orthodox advance directive should stipulate that in the case of incapacity, a close relative may make medical decisions on behalf of the patient. The directive should also indicate that when the patient's condition is considered terminal, he or she is to be spiritually prepared for death through the sacraments of Holy Confession and Holy Communion. When no reasonable hope for recovery remains, the person may be allowed to die. Specifically describing the type of last rites the individual desires and the individual's wish for lucidity during such period is very important.

c. **Catholicism.** Catholics may not forego ordinary means of care, which typically include nutrition and hydration. However, foregoing the use of extraordinary care that prolongs life but otherwise offers no reasonable hope of benefit in a terminal illness is permitted. An agent may never deny nutrition and hydration if they are capable of sustaining human life, as long as this is of sufficient benefit to outweigh the burdens (suffering) to the patient. Pain control is not prohibited, but any type of pain relief that would hasten death must not be administered. Last rites, which includes confession of one's sins and receipt of Holy Communion just prior to death, requires consciousness.

d. **Protestantism Generally**. Protestant faiths respect individual conscience and a person's right to make decisions regarding his or her own body. Individuals are strongly encouraged to discuss end-of-life decisions with their families and spiritual leaders rather than having end-of-life decisions made autonomously, but individuals are also encouraged to execute a healthcare directive that expresses the wish for non-intervention if that is what the individual wants. Protestant denominations

almost universally consider suicide, physician-assisted death, and euthanasia morally wrong. However, allowing a person to die from natural causes by removing him or her from artificial life-support does not fall within the definition of physician-assisted death.

e. **Islam**. Islamic law allows for proxy decision-making by family members. While Islamic law permits the use of living wills, Muslims generally defer to the decisions of healthcare providers and close family members, often parents, rather than the previously expressed opinion of the patient in an advance directive or the decision of any one individual. It is critical for a Muslim to consult an Imam when writing a living will since there are many issues where Muslim law may require interpretation.

f. **Example Directives**. The written materials by Wendy Goffe include examples of modifications to healthcare directives for Orthodox Jews, Orthodox Christians, Catholics, Presbyterians, Christian Scientists, Jehovah's Witnesses, and Muslims. In preparing healthcare directives with modifications to incorporate religious, cultural and other personal desires, "don't make it too elegant." The patient will not want the hospital to send the directive to the legal department to be interpreted while the patient is at the end of life and important decisions must be made.

32. Asian American Cultural Issues Impacting Health Care Issues

a. **Core Values Regarding Family**. Families make decision as a unit (especially for medical decisions and end-of-life decisions). Having the eldest child live at home for years is not uncommon; the oldest son often lives with the parents and his family will move into the home. Information sharing among family members is fully expected. Medical issues are first shared with the family members, and they decide when or if the patient will be told about the medical condition. Terminally ill patients are often not told of the extent of their illness. That seems shocking to the Western world, but is very common in Japan. Asian clients may not understand why legal documentation is necessary to have medical information shared with the family.

b. **Social and Cultural Barriers**. Asian clients are used to less formality in being able to access medical information for the family. Talking about death is considered bad luck; to talk with a family member about his or her death is considered presumptuous.

c. **Language Barriers**. Be careful in using adult children as translators. They may not have the language needed to discuss medical concepts. Furthermore, the Asian language is a "high-context" language. The meaning of words depends upon who is saying the words, the situation in which the words are used, and the relationship between the speaker and listener. In Japanese, the subject matter of the sentence is often dropped. For example, if an individual is asked "do you want life-support?," the literal response may be "would like to avoid drastic measures" "rather than "I would like to avoid drastic measures." A family member may simply translate the response as "I would like to avoid drastic measures," given the context. When the client's words are translated literally, the attorney will not know if the patient wants to avoid drastic measures, or if the family wants to avoid drastic measures, and if so whether the client agrees with the family.

33. Five Tips When Speaking With Non-English Speaking Clients

The following are five practical tips when speaking with non-English speaking clients.

(1) **Do some homework**. Explore the client's culture and likely impediments to effective communication. For example, in Japan clients will have difficulty discussing "death" or "passing away," but will refer to "the inheritance" or "when the inheritance occurs."

(2) **Hire a good translator.** Avoid using a family member or friend as the translator but hire a professional translator. Set ground rules for the translator, asking that words be translated as literally as possible. The attorney will ask clarifying questions as needed.

(3) **Make eye contact.** Look at the client, not the translator. A natural tendency is to speak only to the person who is speaking to you (the translator), but that makes the client feel marginalized.

(4) **Speak slowly and clear.** Speak slowly and clearly, but not necessarily more loudly. Avoid big words and complex sentences. Avoid colloquial expressions ("pull a rabbit out of the hat," "break a leg," "let the chips fall where they may," "get your head around it," "catch you later," etc.).

(5) **Clarify, clarify, clarify.** Repeat back what was heard, and ask questions in multiple ways.

Items 34-38 are observations from a panel by Kurt G. Rademacher, Carolyn Ann Reers, Joshua S. Rubenstein, and Andrew H. Weinstein, discussing "International Variables in the Estate Planning Relationship: Understanding What Your Client Brings to the Table."

34. Attorney/Client Relationship Disconnects

a. **Significance**. While U.S. lawyers and U.S. clients approach the estate planning conversation from the same vantage point (understanding rules of privilege and confidentiality and the need for the lawyer to be well-informed), the U.S. lawyer sitting down for the first time with the client from Asia, EMEA (Europe, the Middle East, and Africa), or Latin America will very likely be faced with multiple cultural disconnects that very tangibly and practically affect the services they are being engaged to provide. As an example, various rules and laws regarding corruption apply in Latin America that may apply to rather straightforward trust estate planning transactions.

b. Privilege Overview. The concept of attorney/client privilege is recognized in most jurisdictions but its scope varies widely; in some jurisdictions it is barely recognized.

EAMEA. In the common law jurisdictions of the United States, the United Kingdom and countries with systems based predominantly on that of the UK (such as Hong Kong and Australia), privilege attaches to confidential documents and communications arising in the context of giving or receiving legal advice. The privilege right belongs to the client and only the client may waive it. (The work product doctrine is a separate concept; it is a protection available to the attorney to protect the attorney's ideas for materials prepared in reasonable anticipation of litigation.)

The United States and UK have similar laws regarding privilege. The United States attorney/client privilege and work product doctrine are approximate equivalents of legal advice privilege and litigation privilege in the UK. Some of the differences regarding privilege in the United States and UK are (i) third-party communications are not protected under UK law unless litigation was reasonably anticipated at the time, but privilege in the United States can extend to communications with third parties if the purpose of the communication is to assist the attorney in providing legal advice, and (ii) the UK allows some degree of selective waiver as long as a document has not entered the public domain, but under U.S. law, disclosure of a single copy of a privilege document to third parties, including regulators (even if that disclosure takes place abroad), results in complete loss of privilege as to the entire subject matter of the privileged documents.

The UK Proceeds of Crime Act of 2002 provides for the civil recovery of the proceeds from crime and is the primary legislation in the UK targeting money laundering. Attorneys (as well as banks and other professional firms) who suspect as a consequence of information received in working with clients that the clients (or others) have engaged in tax evasion or other criminal conduct are required to report their suspicions to authorities, usually without tipping off the client that a report has been made. Limited exceptions exist for legally privileged conversations. Most common law countries have adopted similar rules. (Therefore, one panelist suggests that the client should be advised to hire a New York lawyer, not the UK lawyer.)

Civil Law Jurisdictions. Civil law jurisdictions do not adopt a system of transparency or the obligation to provide disclosure to adverse parties and litigation. The Code of Civil Procedure generally imposes a duty not to disclose confidential obligations, but the client does not have a right to invoke privilege. In some jurisdictions, an attorney may not even be relieved of the duty of confidentiality by the client, although the client can disclose information if he so wishes.

Latin America. Mexico does not regulate privilege *per se*. (The legal profession is not even regulated in Mexico; bar associations are voluntary.) The law establishes obligations of the attorney, not rights of the client. The attorney has an obligation to keep matters confidential, as opposed to the client being entitled to assert privilege. Sanctions for disclosure can involve expulsion, suspension of rights, or other attorney discipline.

Asia. As an example, Singapore recognizes the privilege concept based on British common law. It is broader than the protection in the United States in some ways. For example, the presence of a banker in the attorney conference does not destroy the privilege as it does in the United States.

35. Legal System Disconnects

In Latin America and many civil law countries, contracts are relatively short, because details are described by codes. Offshore trusts tend to be 8-10 pages (with schedules naming beneficiaries who can be moved on or off the schedule very easily).

Trusts are typically not recognized in civil law countries. Even in the UK, courts often view trusts as *per se* shams.

Many civil law countries have forced heirship systems, requiring that certain assets be left to designated individuals.

36. Tax System Disconnects

EAMEA. EAMEA countries (and in most of the world) use a remittance tax basis rather than the U.S. system of worldwide taxation based on citizenship or residence. In those countries, worldwide taxation applies only for resident domiciliaries, which is typically based on the place of original birth. Otherwise, an individual is taxed only on money remitted into that country.

Latin America. Income taxes in Latin America are imposed primarily on companies, not individuals. For example, in Columbia only 18% of revenue comes from individual income tax, and 82% comes from the corporate income tax. Many clients say they don't pay taxes in part due to a lack of enforcement. Clients from Latin America are very surprised when they move to the United States and come to understand that they must pay large income taxes.

Asia. Some Asian jurisdictions (such as Singapore and Hong Kong) have very low tax rates (17%-22%), only home-sourced income is taxed, and capital gains are not taxed. In other Asian countries (such as China, Indonesia, Taiwan, and the Philippines) residents are taxed on a global basis at high rates (at least as high as the U.S. rates) but a general lack of enforcement exists in those jurisdictions and clients do not perceive tax compliance as being important. That is now changing because of increasing global exchange of information. New amnesty programs are being enacted in some Asian jurisdictions to give people an incentive to comply with tax laws.

37. FATCA, CRS and Reporting Requirements

a. **FATCA**. The Foreign Account Tax Compliance Act (FATCA) was enacted by Congress in 2010 to target tax evasion by U.S. taxpayers using foreign accounts. FATCA requires foreign financial institutions (FFIs) to report to the IRS information about financial accounts held by U.S. taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest. FATCA generally requires the FFI to conduct due diligence, to determine if the account owners are U.S. citizens, and to report information about accounts owned by U.S. citizens to the United States. When FATCA was first enacted, other countries were outraged that the U.S. was unilaterally requiring banks in their country to divulge information about U.S. account holders. Eventually, the other countries decided that was a good idea and ultimately developed the Common Reporting Standard (CRS) system as a way of exchanging information with other countries about financial information of owners connected with those other countries.

b. **CRS**. CRS began in 2012 as a pilot initiative of five European countries to follow the FATCA model as a multilateral reporting tool on beneficial ownership. In 2014, the system was adopted by the Organisation for Economic Cooperation and Development (OECD) with a model treaty and Multilateral Competent Authority

Agreement. CRS has now been adopted by over 100 jurisdictions. Of those, 54 will be reporting in 2017 (for activities in 2016), and the remainder will start reporting in 2018 (for activities in 2017).

The participating countries agree under a "common reporting standard" to share information automatically about assets and income in one country of persons having connection with another participating jurisdiction. At some point, the United States is likely to join CRS and have a similar system.

38. Cultural Disconnects

Latin America. In many Latin American countries (for example, including Venezuela), a strong cultural reluctance to disclosing information exists. Clients communicate only what they think the attorney needs to know in order to provide legal advice. Extracting information from clients can be difficult.

Transactions in Columbia are usually closed in person. Clients expect to meet in person and always as soon as possible. While many transactions are carried on electronically in the United States, having face-to-face meetings and exchanging documents and shaking hands is much more important in Columbia.

Exchanging pleasantries and having rather long discussions about personal issues at the beginning and close of meetings is an important part of the culture, showing the client that the personal relationship is a higher priority than just doing business. Leaving immediately after a meeting is perceived as rude and uncaring (stay five minutes or so and continue chatting with the client after the meeting is over).

Asia. Hierarchy matters; address the most senior person first. Business cards are very important – handle them with respect. Place business cards on the table in the order of hierarchy and leave them there during the entire meeting.

Never give a clock as a gift – it reminds the recipient of time and of the recipient's potential death.

As in Latin America, spend a lot of face time discussing pleasantries before talking business. Indeed, various meetings may be held just discussing family matters before business discussions begin at all.

Clients may have concurrent multiple families. One panelist indicates that a number of families he represents in Asia may have three or four branches of the family.