

APPENDIX E
PRIVATE FOUNDATION COMPENSATION ISSUES

Compensation of Private Foundation Trustees

The Discussion Draft would ban compensation to trustees of non-operating private foundations, or, in the alternative, allow it only up to a statutorily prescribed de minimis amount. We believe that current law provides appropriate restrictions on the level of compensation that may be paid to disqualified persons, including foundation trustees and directors. The challenge is in enforcing those restrictions, which we believe is best accomplished by requiring enhanced disclosure on IRS Form 990-PF and by ensuring that the IRS has sufficient resources to identify and examine potential abuses.

Under current federal tax law there is no explicit prohibition against paying compensation to directors or trustees of private foundations, whether operating or non-operating. The tax law instead sets out standards for the level of compensation that is permissible for interested persons generally and imposes disclosure requirements. In the private foundation context, a disqualified person, including a director or trustee, may receive compensation for the performance of certain personal services that are reasonable and necessary to carrying out the foundation's charitable purposes, so long as the compensation is not "excessive."¹ (Under this rule a private foundation may pay compensation that is less than reasonable compensation under a fair market value standard, but not compensation that exceeds reasonable compensation.) The Form 990-PF currently requires disclosure of all compensation paid to directors and trustees.

The tax law also looks to the objectivity of the procedure by which the compensation is determined as a measure of its fairness. In the case of a public charity, the intermediate sanctions rules provide a procedure to invoke a rebuttable presumption of reasonableness in approving compensation arrangements.² A key element in that procedure is reliance on appropriate comparability data. A similar approach could be adopted in the foundation context, focusing in particular on obtaining comparability data concerning compensation paid to foundation directors or trustees.³

Any analysis of whether and how much director or trustee compensation may be reasonable should take into account a variety of factors, such as whether the fiduciary is a professional manager with a market-based rate for compensation (e.g., a trust company in the business of managing charitable trusts), the director's or trustee's job description (e.g., whether the fiduciary is required to devote substantial time to overseeing operations and/or grantmaking), the level of expertise required in fulfilling the fiduciary's duties, any provisions in the non-profit's organizing documents that mandate compensation (e.g., provisions created by the donor/founder in a trust document requiring that the trustees be paid reasonable compensation), and the particular skills and experience that a trustee or director may bring to bear in the role. We believe that an approach to director and trustee compensation that encompasses

¹ See Treas. Reg. § 53.4941(d)-3(c)(1).

² See Treas. Reg. § 53.4958-5.

³ We note that such information is readily available on the internet, e.g. at www.guidestar.org and www.fdncenter.org, and in publications from organizations such as the Council on Foundations, www.cof.org.

consideration of the facts and circumstances of each situation and that includes procedural safeguards in establishing compensation is more likely to enable foundations to attract knowledgeable trustees and directors, while at the same time preventing compensation abuses, than a flat prohibition or cap on trustee and director compensation.

We note that the practice of compensating charitable trustees is longstanding and is codified in the laws of many states. In many instances private foundations formed as trusts have an institutional trustee, such as a bank or a trust company, in addition to or instead of any individual trustee(s). State law commonly governs the types of entities that may serve as institutional trustees.⁴ Institutional trustees typically perform trust services for a large number of organizations and have standardized fees for various types of services. Any prohibition or cap on trustee fees for institutional trustees would certainly provide a substantial disincentive to offering trustee services, and would likely have a significant adverse impact on the ability of foundations to attract responsible institutional trustees. Moreover, institutional trustees assume risk, as fiduciaries held to high standards under state law, and perform valuable services for the foundations that they oversee. It is not apparent that there is any public policy justification for denying such trustees fair market value compensation for their services.

We note further that it is common practice in many states for individual professionals to serve as trustees and at the same time to provide professional services at established competitive rates. This is common particularly in the case of attorneys and accountants, who are often asked to serve as directors and trustees because of trusted relationships with foundation founders who wish their professional advisors to help oversee their philanthropic pursuits, and because of their specialized expertise in the rules applicable to foundations. A prohibition or de minimis cap on compensation would require either that such persons perform their professional services with little or no compensation, or that the foundation forgo the opportunity to have such persons serve in fiduciary positions for the foundation. Under current law there is already an effective cap on professional fees under the rules prohibiting unreasonable compensation. Comparability of compensation for professional services can generally be readily determined with reference to rates charged by other professional firms.

We share the concerns reflected in the Discussion Draft regarding anecdotal reports of substantial compensation being paid to family members who serve as foundation trustees or directors and whose service to the foundation is limited to attending board meetings. We agree that persons who do not perform substantial services should not be permitted to receive substantial compensation. Current law already prohibits payment of excessive compensation to such persons, however. We submit that any abuses in this area stem from a lack of enforcement of current law, due to the limited enforcement resources that the IRS has at its disposal, rather than any inherent weakness in the existing law. We strongly support allocation of sufficient resources to the IRS to identify and examine potential excessive compensation situations through disclosure on IRS Form 990-PF.

⁴ See, e.g., Wash. Rev. Code § 11.36.021 (2004) (trustees must be individuals over the age of 18, trust companies organized under the law of the state, national banks, or nonprofit corporations if their organizing documents so permit).

Compensation of Disqualified Persons.

The Discussion Draft would require non-operating private foundations to use federal government rates to determine compensation paid to disqualified persons for similar work and similar time, other than for persons who are disqualified persons solely by reason of employment. Compensation or severance payments above certain levels would trigger additional disclosure and IRS review, and would require payment of a sliding scale filing fee. Certain compensation would be subject to a requirement of annual approval in advance by the disinterested members of the board of directors.

As with the proposal above concerning compensation to directors and trustees of private foundations, we believe that current law provides appropriate restrictions on compensation levels to disqualified persons, and that the key to addressing the potential for abuse is to enhance enforcement of those restrictions. We are concerned that private foundations should not be denied the opportunity to attract the most qualified staff to assist them in fulfilling their charitable missions – staff to review and develop complex grant proposals, to evaluate varied and myriad grantees administratively and programmatically, and to direct charitable programs. Many private foundations also have substantial assets that must be carefully invested in a manner that complies with state and federal laws and that ensures sufficient liquidity to satisfy annual distribution requirements while also maintaining sufficient assets to support charitable causes well into the future. Foundations need to be able to retain highly-skilled investment managers to manage their resources..

Rather than imposing an additional burden on an already thinly-stretched IRS to review private foundation compensation arrangements on an ad hoc basis and an additional filing obligation on private foundations, we suggest increasing the categories of persons whose compensation must be disclosed on the Form 990-PF and/or lowering the compensation threshold for reporting on Form 990-PF (currently \$50,000). At the same time, the procedures for establishing a rebuttable presumption of reasonableness under the Section 4958 intermediate sanctions regulations could be applied to compensation paid to disqualified persons in the private foundation context. It may also be appropriate to require foundations to provide evidence of whether and how they have satisfied the presumption, as an aid to the IRS in identifying potential situations of noncompliance.