

Trending Legal Issues

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Agenda

- Potential Impact of SFFA v. Harvard/UNC
- Grantmaking to non-charities

Potential Impact of SFFA v. Harvard/UNC

- The Court held that admissions programs at both institutions violated the law:
- UNC – Equal Protection Clause of the 14th Amendment
 - Prohibits federal and state governments from discrimination on the basis of race except when furthering a compelling government interest and using the least restrictive means available.
- Harvard – Title VI of the Civil Rights Act of 1964
 - prohibits discrimination on the basis of race, color, and national origin in any program or activity receiving federal financial assistance.

Potential Impact of SFFA v. Harvard/UNC

- The Court found that the educational benefits of a diverse student body are not a compelling government interest because:
 - Diversity goals “lack sufficiently focused and measurable objectives warranting the use of race.”
 - There was no meaningful connection between the admissions process and the educational benefits of diversity because of the imprecise racial categories used that the Court considered either overbroad or underinclusive.

Potential Impact of SFFA v. Harvard/UNC

- Court did not rule on:
 - US military academies
 - Scholarships
 - Use of race-neutral factors that might serve as a proxy for race
 - DEI initiatives by employers
- Limited direct immediate impact on foundations and nonprofits, but lots of questions about future impact
- Pending and future litigation will likely take years to work through all of these issues

Potential Impact of SFFA v. Harvard/UNC

Title VI application to foundations and nonprofits:

- Federally funded activities or programs are subject to Title VI
- For most organizations, Title VI nondiscrimination provisions do not extend to other non-federally funded programs and activities
- Organizations that are principally engaged in providing education, health care, housing, social services, or parks and recreation and receive federal funding are subject to Title VI in **all** areas of their activities, not just the specific program that received federal funding.
- PPP Loan recipients are subject to Title VI only as long as the loan is outstanding – once paid back/forgiven those requirements end.

Potential Impact of SFFA v. Harvard/UNC

Section 1981:

- Enacted as part of the Civil Rights Act of 1866
- Prohibits discrimination on the basis of race and ethnicity when making or enforcing contracts. Specifically, it grants “all persons...the same right...to make and enforce contracts...as is enjoyed by white citizens.”
- Only covers discrimination based on race or ethnicity.
- Applies to private actors/parties.

Potential Impact of SFFA v. Harvard/UNC

Section 1981 – application to foundation grantmaking:

- Only applies to contracts, not gifts
- Foundation grants may or may not be contracts, depending on language in grant agreement
- Whether a contract exists is ultimately for a court to determine based on the standard used in that jurisdiction
- In general, the fewer requirements imposed on a grantee the less likely it might be construed as a contract

Potential Impact of SFFA v. Harvard/UNC

Pending litigation:

- American Alliance for Equal Rights v. Fearless Fund
 - First legal challenge of a charitable grant program under a Section 1981 claim following SFFA decision
 - District court denied plaintiff's motion for a preliminary injunction, saying that defendant's actions were protected by the First Amendment
 - 11th Circuit Court of Appeals reversed that decision on September 30, granting the motion for a preliminary injunction before the grant cycle closed

Grantmaking to non-charities

- Many foundations ask about granting to nonprofits that are not 501(c)(3) public charities or 170(b)(1)(A) organizations (i.e., 501(c)(4), 501(c)(6), 501(c)(7), 501(c)(13), etc.) or even to for-profit entities.
- Always look at governing documents and grantmaking policies to see if permissible
- If so, determine whether the grant furthers an exclusively charitable purpose and evaluate any potential benefit to private interests
- Specific due diligence requirements depend on status of grantor

Grantmaking to non-charities

Charitable purposes:

- Listed in IRC section 170(c)(2)(B):
 - Religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.
- Treasury Regulations at 1.501(c)(3)-1(d)(2) define “charitable”
 - Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or
 - (i) to lessen neighborhood tensions;
 - (ii) to eliminate prejudice and discrimination;
 - (iii) to defend human and civil rights secured by law; or
 - (iv) to combat community deterioration and juvenile delinquency.

Grantmaking to non-charities

Private Benefit Doctrine:

IRC Section 501(c)(3) - **organized and operated** exclusively for charitable, religious or educational purposes, **no . . . benefit of any private shareholder or individual.**

Treasury Regulation Section 1.501(c)(3)-1(a)(1) - Section 501(c)(3) organization must be both **organized** and **operated** exclusively for one or more [charitable] purposes . . . If organization fails to meet either the organizational test or the operational test, it is not exempt.

- Severe consequences for violating – **ONLY** consequence is loss of exempt status
- Two-part analysis:
 - Qualitatively – Is the private benefit necessary AND incidental in order to achieve public purpose?
 - Quantitatively – Is the private benefit no greater than necessary in order to achieve a public benefit? (Balancing Test)

Grantmaking to non-charities

Due diligence requirements:

- For private foundations, any grant to an organization that is not a public charity require the foundation to exercise expenditure responsibility.
- For public charities, no formal procedures are legally mandated – the organization can take any steps it concludes to be necessary in order to document that grant funds will be used for an exclusively charitable purpose.
 - EXCEPTION – if the grant is coming from a donor advised fund, the DAF sponsor must exercise expenditure responsibility.

Grantmaking to non-charities

Expenditure Responsibility

Five basic steps:

1. Pre-grant inquiry
2. Written agreement
3. Separate account
4. Regular reports
5. 990-PF reporting (private foundations only)

Grantmaking to non-charities

Expenditure Responsibility

Step One – Pre-grant inquiry

- Identify prior history and experience of grantee
- Knowledge of management, activities, and practices of grantee
- Scope may vary depending on size of grant and prior experience with grantee

Grantmaking to non-charities

Expenditure Responsibility

Step One – Pre-grant inquiry (continued)

Common documentation (not legally required)

- Evidence of legal status
- Description of grantee's recent activities and future plans
- A recently audited financial statement
- Grantee's governing board and key officers
- Description of any prior experience with the grantee
- Evidence of grants made to other organizations
- Brief report of any site visit

Grantmaking to non-charities

Expenditure Responsibility

Step Two – Written Grant Agreement

- Form not important, but must be in writing
- Officer, director, or trustee of the grantee must sign
- Must:
 - Specify the charitable purpose of the grant
 - Require the grantee to maintain the funds in a separate account

Grantmaking to non-charities

Expenditure Responsibility

Step Two – Written Grant Agreement (continued)

- Grantee must agree to:
 - Repay any portion not used for the purposes of the grant
 - Submit full and complete annual reports
 - Maintain records of receipts and expenditures
 - Make its books and records available at reasonable times

Grantmaking to non-charities

Expenditure Responsibility

Step Two – Written Grant Agreement (continued)

- Grantee must agree *not* to:
 - Lobby: carrying on propaganda or attempt to influence legislation
 - Influence elections: promote or oppose candidates, support or conduct voter registration drives
 - Re-grant to individuals or non-charities unless the grantee agrees to follow the private foundation rules when it re-grants
 - Undertake any activity for any purpose other than §170(c)(2)(B)

Grantmaking to non-charities

Expenditure Responsibility

Step Three – Separate Account

- Key is to prevent comingling of funds
- Regulations say “in a separate fund”
- Must use either:
 - A physically separate bank account; or
 - A separate bookkeeping account
- Grants to other private foundations are excepted from this requirement

Grantmaking to non-charities

Expenditure Responsibility

Step Four – Grantee Reporting

- Substance – report must include information about
 - Use of the funds
 - Compliance with the terms of the grant
 - Progress made in achieving goals
- Frequency
 - First report – due at the end of grantee’s annual accounting period
 - Ongoing – due each year until funds are expended in full
 - Final – full report on all activity over the life of the grant
 - (For short-term grants, these may all be the same)
- Verification
 - No need to verify reports unless reliability is in doubt

Grantmaking to non-charities

Expenditure Responsibility

Step Five – IRS Reporting

- 990-PF reporting
 - First year a grant is made
 - Each year funds or a report are outstanding
- Contents
 - Name and address of the grantee
 - Date and amount of the grant
 - Purpose of the grant
 - Grantee expenditures based on latest report
 - Report any diversion of funds
 - Dates of any reports received from the grantee
 - Date and result of verification conducted (if any)

Grantmaking to non-charities

Expenditure Responsibility

Step Five – IRS Reporting (continued)

- Record Keeping
 - Regulation require that the grantor keep the following documents for IRS inspection:
 - Copy of the agreement
 - Copy of each report received
 - Copy of any audits or other investigations
 - Keep pre-grant inquiry as well

Questions?

Contact information

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