

## AN OPERATIONS CHECKLIST FOR FOUNDATION COMPLIANCE

### LEGAL REQUIREMENTS AND OPERATIONAL BEST PRACTICES FOR PRIVATE FOUNDATIONS AND PUBLIC CHARITIES

*Updated as of May 2022*

*This information is provided by Ask CMF, a technical assistance service of the Council of Michigan Foundations, for educational purposes only and does not constitute legal advice.*

This resource is intended to provide an overview of compliance needs and opportunities for both private foundations and public charities with grantmaking operations. The information included here is most effective when used to support proactive planning for both frequent and infrequent operational activities, ranging from submission of government-issued forms and retaining essential historical documents to regular grantmaking. This resource can also be used to identify areas of operations that may already be out of compliance and need to be addressed.

Foundations should periodically discuss issues of compliance and the nature of their operational activities with qualified legal counsel, tax counsel and other external counsel to ensure that required activities are being carried out appropriately. Boards should also be made aware of key requirements, especially as they engage with investments, audits and other activities on behalf of the organization.

Please note that this resource is primarily designed for leanly-staffed organizations (0-8 staff). Larger organizations may have additional tasks due to the size or complexity of their facilities and operations.

While organizational operations among foundations differ based on asset size, staffing and other factors, this document outlines activities that represent best practices and legal requirements for most institutions in the field.

CMF members looking to develop or update policies and documentation related to areas of compliance and beyond can access the CMF Sample Documents Hub, available at [www.michiganfoundations.org/sampledocs](http://www.michiganfoundations.org/sampledocs).

## Color-Coding Guide for This Resource

Organizations may have different legal requirements, depending upon the institution’s respective designation:

- **Public Charities:** This category includes community foundations, grantmakers with broad donor support, community college foundations and other charitable organizations. These organizations complete an IRS Form 990 and do not need to follow additional legal requirements specific to private foundations. Unlike private foundations, public charities may have fundraising responsibilities, which are noted within the Fundraising and Donor Development section of this document.
- **Private Foundations:** This category includes family foundations, corporate foundations and other grantmaking entities that are required to follow private foundation requirements set by the IRS. These organizations are required to complete an IRS Form 990-PF, as well as adhere to rules prohibiting private benefit and inurement to individuals and organizations. These organizations are intended to serve the public benefit and should not be used to benefit “insiders,” including officers, directors, key employees, their family members and certain others. Failure of private foundations to follow these rules may result in excise taxes (including personal liability for certain insiders) or the loss of the organization’s tax-exempt status, among other penalties.

**TEXT IN TEAL:** For the purposes of this resource, legal requirements or other mandated activities for both types of organization are designated in teal throughout this document.

**TEXT IN ORANGE:** For purposes of this resource, additional legal requirements for private foundations are designated in orange throughout this document.

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## Legal and Operational Compliance Checklist

This checklist provides a brief synopsis of the required and recommended activities of private foundations and public charity grantmakers. Additional information on each of these topics is featured on the remaining pages of this document.

### Key:

- Legal requirements or other mandated activities are designated in **teal**.<sup>1</sup>
- Best practices and recommended activities are designated in **black**.

✓	Category/Activity	Private Foundations	Public Charity Grantmakers
<b>Organizational Documents</b>			
	Articles of Incorporation/Trust Agreement	Required	Required
	Bylaws <sup>2</sup>	Required	Required
	Registration with the Michigan Attorney General <sup>3</sup>	Required	Required
	Changes and Amendments	Required, if applicable	Required, if applicable
	Form 1023/1023 EZ (if eligible)	Required	Required
	Form SS-4	Required	Required
	IRS Determination Letter	Required	Required
	IRS Approval of Grantmaking Procedures	Required	N/A
	Other Official Correspondence with the IRS	Required	Required
<b>Administration and Operations</b>			
	Record Keeping and Records Retention	Required	Required
	Business Continuity Plan/Disaster Recovery Plan	Recommended	Recommended
	Health and Safety Procedures <sup>4</sup>	Required	Required
	Public Facility Requirements	Required, if applicable	Required, if applicable
	Internal Rental or Facility Agreements	Recommended, if applicable	Recommended, if applicable
<b>Human Resources</b>			
	Required Filings for Staffed Foundations: 1. FICA 2. Federal, State, and Local Income Tax Withholding 3. Reporting for Fringe Benefits	Required for Staffed Foundations	Required for Staffed Organizations
	Workers Compensation Insurance	Required for Most Staffed Organizations	Required for Most Staffed Organizations

<sup>1</sup> Please note that community foundations involved in the National Standards for U.S. Community Foundations program may have other required policies and procedures than those listed here. For more information, see <https://www.cfstandards.org/>.

<sup>2</sup> Required for corporate entities, but not required for trusts.

<sup>3</sup> Charitable trust registration is required for private foundations, unless they solicit. COSA license required for public charities.

<sup>4</sup> Required for organizations with employees.

	W-9; 1099 for Non-employment Payments over \$600 to Non-Corporations <sup>5</sup>	Required, if applicable	Required, if applicable
	Maintain Necessary Employee Files	Required	Required
	Consultant and Contracted Personnel Contracts	Recommended, if applicable	Recommended, if applicable
	Employee Salary Benchmarking	Recommended	Recommended
	Benefits	Recommended	Recommended
	Employee Handbook <sup>6</sup>	Recommended	Recommended
	Intern and/or Volunteer Policies	Recommended	Recommended
	Performance Reviews	Recommended	Recommended
	Professional Development	Recommended	Recommended
	Reimbursement Policy	Recommended	Recommended
	Telecommuting and Remote Worker Policy	Recommended	Recommended
	Staff Conflict of Interest Policy	Recommended	Recommended
	Succession Planning	Recommended	Recommended
<b>Strategy and Evaluation</b>			
	Strategic Plan	Recommended	Recommended
	Annual Evaluation Plan	Recommended	Recommended
	Annual Staff Survey	Recommended	Recommended
<b>Communications</b>			
	Annual Report	Recommended	Recommended
	Communications Plan	Recommended	Recommended
	Marketing Collateral	Recommended	Recommended
	Crisis Communications Plan	Recommended	Recommended
	Social Media Policy	Recommended	Recommended
	Brand Guide	Recommended	Recommended
<b>Board Governance</b>			
	Regular Board Meetings	Required	Required
	Board Meeting Minutes	Required	Required
	Board Development and Succession Activities	Recommended	Recommended
	Attending Fundraisers Policy	Recommended <sup>7</sup>	N/A
	Board Membership Policy	Recommended	Recommended
	Conflict of Interest Policy	Required	Required
	Perpetuity or Sunsetting Policy	Recommended	N/A
	Personnel Policies	Recommended	Recommended
	Spending Policy	Recommended	Recommended
	Investment Policy	Recommended	Recommended
	Travel and Reimbursement Policy	Required	Recommended
	Whistleblower Policy	Required	Required
	Performance and Compensation for Executive Director	Required	Required
<b>Finance</b>			
	Excise Tax on Net Investment Income	Required	N/A
	Required Minimum Payout Rate	Required	Recommended
	Limits on Self-Dealing and Excess Business Holdings	Required <sup>8</sup>	N/A

<sup>5</sup> This is applicable to consultants, professional fees, and director/trustee fees.

<sup>6</sup> Please note that, while an employee handbook is not required, many disclosures included within it are required.

<sup>7</sup> While this policy is not required, organizations may encounter self-dealing issues if guidelines are not followed.

<sup>8</sup> This is also a requirement for Donor Advised Funds.

	Jeopardy Investments	Required <sup>9</sup>	N/A
	Form 990-T for Unrelated Business Income	Required	Required
	Create and Approve Organizational Budget	Recommended	Recommended
	Financial Audit	Recommended	Required for some
	Balance Sheet and Other Financial Statements	Required	Required
	Investment Policies and Managers	Recommended	Recommended
	Insurance	Recommended	Recommended
<b>Legal and Tax Issues</b>			
	Limits on Taxable Expenditures	Required	Recommended
	Completion of the Form 990-PF or Form 990	Required	Required
	Foundation Voluntary Termination/Dissolution	Required, when applicable	Required, when applicable
	Form 990-PF Schedule B	Required	Required <sup>10</sup>
	Form 990-T	Required, when applicable	Required, when applicable
	Employment Tax Returns	Required	Required
	Michigan Sales and Use Tax Certificate for Exemption	Required	Required
	State Corporate Filing and Income Tax	Required	Required
	State Sales and use Tax	Required, when applicable	Required, when applicable
	Local Real and Personal Property Tax or Tax Exemption Filing	Required, when applicable	Required, when applicable
	Local Business Licenses	Required, when applicable	Required, when applicable
<b>Grantmaking and Programmatic Activities</b>			
	Grant Guidelines	Recommended	Recommended
	Grant Application Forms and Process	Recommended	Recommended
	Site Visits	Recommended	Recommended
	Grant Reports	Recommended	Recommended
	Discretionary Grants Policy	Recommended	Recommended, if applicable
	Disaster Grantmaking Policy	Recommended	Recommended, if applicable
	General Operating Support Grants or Other Categories of Grantmaking Policies	Recommended	Recommended
	Grants to Individuals Policy	Required, when applicable	Recommended
	Grants to Non-501(c)(3) Policy	Recommended	Recommended
	Grants Supporting Legislative Activities Policy	Recommended	Recommended
	International Grants Policy	Recommended	Recommended
	Multi-Year Grants Policy	Recommended	Recommended
<b>Fundraising and Donor Development</b>			
	Charitable Solicitation License	N/A (unless applicable)	Required
	Engaging a Professional Fundraiser	N/A	Required, when applicable

<sup>9</sup> This is also a requirement for Donor Advised Funds.

<sup>10</sup> Charities do not have to publicly disclose names and addresses of contributors as part of required IRS forms.

	Donor Acknowledgement Letters	Required, when applicable	Required
	Quid Pro Quo Donations	Required, when applicable	Required, when applicable
	Record Keeping	Required, when applicable	Required, when applicable
	Donor Data and Privacy	Recommended <sup>11</sup>	Recommended
	Gift Acceptance Policy	N/A	Recommended
	Donor Initiated Fundraising Policy	N/A	Recommended
	Charitable Gaming	N/A	Required, when applicable
<b>Technology</b>			
	Multi-factor Authentication	Recommended	Recommended
	Technology Audit	Recommended	Recommended
	Training	Recommended	Recommended
	Geofencing	Recommended	Recommended
	Backups	Recommended	Recommended
	Customer Relationship Management (CRM) and Other Databases	Recommended	Recommended
	File Server	Recommended	Recommended
	Financial Software	Recommended	Recommended
	Grants Management Software (GMS)	Recommended	Recommended
	Log-In/User Management	Recommended	Recommended
	Payroll Software	Recommended	Recommended
	Data Privacy Policy	Recommended	Recommended
	Acceptable Use Policy	Recommended	Recommended
	Data Ownership Policy	Recommended	Recommended
	Data Retention Policy	Recommended	Recommended
	Digital Transition of Paperwork	Recommended	Recommended
	Devices Updates and Protection	Recommended	Recommended

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<sup>11</sup> While privacy policies may vary between private foundations and public charities, organizations should ensure that information about grantees, donors, and other people and institutions are kept private.

## Organizational Documents

- **Articles of Incorporation or Trust Agreement:** The organization must have a formative document that sets its initial purpose and structure. For corporate entities, articles of incorporation are filed with the State of Michigan. In the case of a trust, the trust document is not required to be filed. Articles of Incorporation should be reviewed periodically. The foundation should ensure its Articles of Incorporation and related policies are in compliance with current state law, as the Michigan Nonprofit Corporation Act had significant updates in both 2009 and 2015.
- **Bylaws:** If organized in corporate form, the foundation should have a bylaws document that outlines the rules for running day-to-day operations and governance. The bylaws should be periodically reviewed and updated to ensure they meet with federal and state requirements, and match the organization's policies and procedures.
- **Registration with the Michigan Attorney General:** Under the Supervision of Trustees of Charitable Purposes Corporations Act (STCPA), all entities holding charitable assets in Michigan must be registered. If the entity secures a charitable solicitation license under the Charitable Organizations Solicitations Act (COSA), it will be automatically registered under STCPA.
- **Changes and Amendments:** If a foundation is registered to solicit charitable contributions under COSA, it must notify the Attorney General within 30 days of any changes to its address, name, additional names under which it solicits, the Board of Directors or the organization's resident agent. For foundations registered under the STCPA, the Attorney General must be notified of changes in officers or directors or the foundation's address. Changes to the address or registered agent must be submitted through the Department of Licensing and Regulatory Affairs (LARA) at the state of Michigan. Changes to Articles and Bylaws should be filed with the Michigan Attorney General with the annual information update and with the IRS with the next tax return. (Changes are reported on the Form 990.)
- **Retaining Federal Tax Documents:** The foundation will periodically correspond with the IRS and other federal agencies regarding its grantmaking and operations. Copies of the following documents should be kept on file by the foundation:
  - **Form 1023:** Application for tax-exempt status by the IRS and any affiliated correspondence.
  - **Form SS-4:** Application for Employee Identification Number (EIN)
  - **IRS Determination Letter:** This letter certifies the foundation is exempt and classifies the organization as a private foundation, private operating foundation or public charity (including a supporting organization).
  - **IRS Approval of Grantmaking Procedures:** This document may be required for some foundations, especially **private foundations** that provide grants to individuals.
  - **Other Official Correspondence with the IRS**

## Administration and Operations

- **Record Keeping and Records Retention:** The records retention and whistleblower provisions of the Sarbanes-Oxley Act of 2002 pertain to tax-exempt organizations and impose potential criminal penalties for violation. Further, the Form 990 (Part VI) asks whether the foundation has adopted the various potential policies noted. Due to the public nature of the form, it is optimal that the foundation has these policies in place.<sup>12</sup> Each foundation should maintain files of essential documents, including policies, meeting minutes, filed tax and legal forms, and incorporation documents. This information should be covered by a records retention policy. Records related to tax filings and other IRS activity should be maintained for three years after the tax return is due/filed. Records for active grants must be maintained throughout the duration of the grant, even if this is a longer period than outlined within the records retention policy. The records retention policy and process should also include a means for properly retaining digital/electronic files, with appropriate off-site backup.
- **Business Continuity Plan/Disaster Recovery Plan:** The foundation should have a plan in place to ensure that the organization's critical operations continue to function in case of a crisis. It may include information related to standard operational functions, essential recordkeeping and data, and employee contacts. A disaster recovery plan may focus exclusively on data and information systems that should be backed up, recovered or restored in case of an emergency.
- **Health and Safety Procedures:** The foundation should ensure that all necessary health and safety procedures are in place, including those related to applicable OSHA regulations.
- **Public Facility Requirements:** Foundations must follow local, state and federal requirements related to such matters as local fire codes and signage, Department of Labor posters, OSHA requirements, Michigan employment laws and the American with Disabilities Act.
- **Internal Rental or Facility Agreements:** Some organizations manage facility use for both internal and external groups. Agreements with external groups should be periodically reviewed and retained for appropriate periods of time.<sup>13</sup> General guidance should also be developed to document procedures for considering, approving and monitoring meetings and events, as well as establishing a fee structure, agreements and coordination for this category of activity.

## Human Resources

- **Required Filings for Staffed Foundations:** Foundations with paid staff are required to file the following:
  - **FICA** (Social Security and Medicare)
  - **Federal, State, and Local Income Tax Withholding:** Including unemployment insurance following state requirements.
  - **Reporting of Fringe Benefits**

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<sup>12</sup> National Standards requires a record retention and destruction policy as part of its certification process for community foundations.

<sup>13</sup> National Standards recommends that all formal contracts be maintained for 7 years after all obligations end.



- **Workers Compensation Insurance:** Most organizations in the state of Michigan must obtain workers' compensation insurance, with limited exceptions.
- **Filings for Consultants, Professional Fees, and Director/Trustee Fees:** These filings may include W-9 and 1099-MISC forms.
- **Maintain Necessary Employee Files:** These files should include an I-9 form for each employee separate from the personnel file, and a medical file separate from the personnel file, and include additional documentation, such as Form W-4 (Employee's Withholding Allowance Certificate), federal and city withholding, an employment application, job description, a copy of the individual's resume and offer letter for employment (or employment agreement). Specific benefit forms will also need to be maintained. Please note that it is increasingly common for many of these documents to be contained within an electronic record system.
- **Consultant and Contracted Personnel Contracts:** Foundations may have periodic or ongoing contracts with consultants, contracted personnel, external counsel (legal, financial, tax, etc.) and other vendors. These contracts should be maintained and periodically reviewed for timeframes, relevance and terms. Contracts for professional fundraisers and related fundraising activities have additional rules. (See Fundraising and Donor Development section.)
- **Employee Salary Benchmarking:** The foundation should consider participating in industry-specific salary surveys to support benchmarking for comparable staff positions for the upcoming year.
- **Benefits:** Organizations may periodically evaluate their employee benefits packages, including retirement and health insurance plans.
- **Employee Handbook:** Relevant staff (or a board committee) may periodically review the employee handbook to ensure that workplace procedures and policies fit with in-office and remote workforce needs, best practice and legal requirements.
- **Intern and/or Volunteer Policies:** Foundations may consider creating or updating policies (or handbooks) specific to the needs of interns and/or volunteers who regularly interact with the organization's facilities, technology and staff.
- **Performance Reviews:** Foundation staff should receive performance reviews, with clear communication regarding any connection between performance and compensation decisions.
- **Professional Development:** Organizations may choose to designate a budget and priorities for staff professional development, either at an institutional or individual level.
- **Reimbursement Policy:** Similar to a travel and reimbursement policy for board members, this policy should outline appropriate expenses that may be reimbursed for staff and the process involved, including documentation as required by the IRS.
- **Telecommuting and Remote Worker Policy:** This policy outlines conditions and procedures for remote work.
- **Staff Conflict of Interest Policy:** Similar to the board's conflict of interest policy and related procedures, staff, most volunteers, and other affiliated parties should annually complete a conflict of interest disclosure form, agreeing to the policy and disclosing any actual or potential conflicts of interest.

- **Succession Planning:** This plan should outline emergency/short-term plans for leadership staff and board members, particularly in the case that an executive resigns or is otherwise unable to carry out their responsibilities. In case of an emergency concerning the executive director or a sole staff member, a copy of this material should be kept in a known location or with the current board chair.

## Strategy and Evaluation

- **Strategic Plan:** The foundation should develop or review its multi-year strategic plan, using key objectives and outcomes to guide the organization’s work throughout the year. The strategic plan should be approved by the full board, with input from key internal and external stakeholders.
- **Annual Evaluation Plan:** An annual evaluation plan may include dynamic components such as research planned for the year (i.e., issue area academic research, surveys, focus groups) and goals for that research, and/or an overview of the qualitative and quantitative data the organization intends to capture about its own activity during the course of the year to then report on – internally and/or externally – at the end of the year. An annual evaluation plan can also feature relatively static components such as the organization’s philosophy for evaluation. The organization should implement or adjust the annual evaluation plan to represent the current institutional strategy.
- **Annual Staff Survey:** The foundation may choose to evaluate internal satisfaction, capturing future-focused needs and opportunities.

## Communications

- **Brand Guide:** This guide may feature standard language used to describe the organization’s mission, vision and values as an elevator pitch, narrative around the organization’s brand voice and tone, an inclusive language guide, style components (i.e., typography, color palette, graphic/logo usage), media roles and responsibilities, and/or other components that help to maintain integrity, consistency and clarity around what the organization is, who it serves and why.
- **Annual Report:** This publication (print and/or digital) of foundation finances, operations and/or programs may be intended for external stakeholders but can also be a resource and tool for internal audiences (staff, board, etc.).
- **Communications Plan:** Found most frequently in organizations with designated communications staff, a communications plan outlines the annual set of activities coordinated by the communications team or staff person, highlighting communications pieces produced by this division. This plan and related documents may also include information such as printed material deadlines, a social media editorial calendar and/or website and digital content strategy.
- **Marketing Collateral:** This material may include printed matter such as brochures, one-pagers or digital images, infographics or testimonial quotes that speak to specific projects, initiatives or

goals of the foundation. This collateral is often leveraged to promote scholarships, development activities or events, or support engagement with current and potential donors.

- **Crisis Communications Plan:** This plan ensures staff and applicable volunteers have a clear, shared understanding of appropriate organizational procedures in the face of a potential crisis. This plan may include emergency contact information, a calling tree, sample communication protocols and procedures specific to a variety of emergency situations (i.e. severe weather, office closures).
- **Social Media Policy:** This policy describes the organization's expectations of staff and trustees (internal audiences) as it relates to their engagement on social media individually and in relationship to one another and the organization's stakeholders. It speaks to risks and responsibilities ranging from referencing the foundation in posts and personal profiles to political campaigning and the importance of reporting inappropriate behavior. A social media policy can also be used to support and encourage staff and volunteer use of social media as brand ambassadors.

## Board Governance

- **Regular Board Meetings:** Foundations are required to schedule and hold regular board meetings, at a minimum of once a year. These meetings are also required to hold elections and manage the business of the organization.
- **Board Meeting Minutes:** Organizations are required to take minutes during board and committee meetings and approve minutes of the previous board meeting.
- **Board Development and Succession Activities:** In order to strengthen and perpetuate the governance functions of the organization, board members are responsible for establishing a process to educate the board on topics related to the organization and their governance role. This process should include some form of board self-assessment or evaluation to ensure board members remain active participants within the organization's governance efforts. Additionally, the board should establish a means to recruit and retain board members, as well as follow its bylaws and other policies to elect/re-elect members to the board.
- **Create, Approve, and Update Board Governance and Institutional Policies:** Foundation boards should ensure the following policies are created, and regularly updated as needed:
  - **Attending Fundraisers:** In the case of **private foundations**, board members should adhere to restrictions on the organization paying for special event tickets and board members (and family members) attending these events.
  - **Board Membership:** The foundation should have established policies related to the required activities and criteria of existing board members, as well as the recruitment and election process for new board members.
  - **Conflict of Interest:** The foundation (public charity or **private foundation**) should have a clear conflict of interest policy, as well as a form or process for board members to report

potential areas of conflict with their board service. These forms should be updated annually.<sup>14</sup>

- **Perpetuity or Sunset Policy:** Some (usually **private**) foundations have a policy or other document that outlines the intended lifespan of the organization, whether limited to a certain number of years beyond the founder's death, a length of time beyond a certain date or in perpetuity (without an intended end date).
- **Personnel Policies:** For some leanly-staffed foundations, the board is responsible for approving policies related to staff members. In other cases, this work may be undertaken by a committee or an HR department/professional. (See the Human Resources section for further detail.)
- **Spending Policy:** The organization (typically a public charity) should have a spending policy that outlines how much of the foundation's assets are utilized for grantmaking and operations.
- **Investment Policy:** The foundation should have an investment policy which outlines the plan for investing, managing and spending the institution's asset pool, as well as the role of staff, board members, an investment committee and external advisors (investment management service providers) in this process. It should include information related to acceptable levels of risk, liquidity requirements, rebalancing methodologies, overall asset allocation and impact investing, if applicable. This policy should be reviewed annually.
- **Travel and Expense Reimbursement Policy:** This policy outlines the rules for reimbursements to board and/or staff members to cover travel and other business-related expenses. For **private foundations**, this policy should be tailored to avoid self-dealing.
- **Trustee Compensation:** In some cases, foundations have a designated policy that outlines board members' compensation, including how the organization may reimburse them for expenses related to attending meetings and conducting other foundation-related business, as well as ensuring that compensation is reasonable and not excessive based on comparable data. Board members should not be compensated based on a percentage of the foundation's assets or income.
- **Whistleblower Policy:** This policy outlines the process for board and staff members, as well as related parties, to report inappropriate behavior and activity to the organization. Foundations are asked about this policy on their IRS Form 990. (See Record Keeping and Records Retention for further detail.)

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<sup>14</sup> This policy is related to regulations against self-dealing by disqualified persons (see IRC Section 4941), which prohibits most financial transactions with disqualified persons (including substantial contributors, board members, related corporations, and related family members). This could result in excise taxes on foundation managers and those involved in self-dealing activities. This is specific to **private foundations**.

- **Performance and Compensation for Executive Director:** The board is responsible for conducting annual/regular performance reviews for the foundation executive director/CEO. Depending on the size of the organization, the board may be responsible for evaluating other staff or this may be managed by an HR staff person or department. The performance review is oftentimes associated with review of the staff person’s salary, benefits and other forms of compensation. Executive and staff compensation must be considered reasonable and not excessive as based on comparable data sources for equivalent staff functions, skill level and experience at equivalent organizations.

## Finance

- **Excise Tax on Net Investment Income:** Internal Revenue Code (IRC) Section 4940 requires the quarterly payment of excise tax by **private foundations**, currently set at 1.39%.
- **Required Minimum Payout Rate:** IRC Section 4942 requires that a private foundation annually distributes a certain percentage of its assets for exempt/charitable purposes and is equivalent to approximately 5% of average net investment assets for the prior year (non-charitable assets). Qualifying distributions include paid grants and related administrative expenses required to manage the foundation’s charitable activity (but not investment activity; that reduces the tax on net investment income). Private foundations have one year to meet the payout requirement. This is specific to **private foundations**, but used as best practice by many public charities with regard to their grantmaking.
- **Limits on Self-Dealing and Excess Business Holdings:** Per IRC Section 4943, disqualified persons, in general, are those who are “in a position to exercise substantial influence over the affairs” of the foundation, including substantial contributors (including a related corporation), trustees, directors, officers, other foundation managers, the family members of all of them and certain other entities.<sup>15</sup> A foundation and its disqualified persons together can only hold up to a certain amount (typically 20%) of the voting shares or membership interests in a business enterprise, with a limited amount of time to divest their excess holdings. Private foundations are required to ask their disqualified persons about their holdings in any securities in which the foundation

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1. All [substantial contributors](#) to the foundation,
  2. All [foundation managers](#) of the foundation,
  3. An owner of more than 20 percent of--
    - a. The total combined voting power of a corporation,
    - b. The profits interest of a partnership, or
    - c. The beneficial interest of a trust or unincorporated enterprise, which is, during the ownership) a [substantial contributor](#) to the foundation,
  4. A [member of the family](#) of any of the individuals described in (1), (2), or (3),
  5. A corporation of which more than 35 percent of the total combined voting power is owned by persons described in (1), (2), (3), or (4),
  6. A partnership of which more than 35 percent of the profits interest is owned by persons described in (1), (2), (3), or (4),
  7. A trust, estate, or unincorporated enterprise of which more than 35 percent of the beneficial interest is owned by persons described in (1), (2), (3), or (4).

owns more than 2% of the overall voting shares or membership interests.<sup>16</sup> Excise taxes may result in a foundation for violating these rules. This is specific to **private foundations** and Donor Advised Funds (DAFs).

- **Jeopardy Investments:** Per IRC Section 4944, a foundation may be penalized for participating in investments that may jeopardize its exempt purposes. Examples of these types of investments in the IRC include commodities futures, trading on margins, “calls” and “puts,” and other strategies that place the foundation’s investments at risk. This category does not include program related investments and permits foundation managers to take into account the investment’s relationship to the charitable purposes of the foundation with regard to mission investments. From a state law perspective, UPMIFA has similar requirements mandating a prudently diversified portfolio. This is specific to **private foundations** and DAFs.
- **Form 990-T for Unrelated Business Income:** Foundations must file Form 990-T to report unrelated business income, such as income from debt financed investment property and publicly-traded partnerships. (See Legal and Tax section for additional information.)
- **Create and Approve Organizational Budget:** Depending on the size and complexity of the foundation, this activity may be conducted by a CEO, finance staff person or department, or members of the board.
- **Financial Audit:** Many foundations regularly conduct an audit due to the size and complexity of their financial operations. The audit process is designed to ensure that the organization’s financial statements are accurate and complete, while internal controls function in compliance with generally accepted accounting principles. Organizations should ideally seek an auditor with experience working with nonprofits and/or grantmaking foundations. Foundations that hold a charitable solicitation license and that have contributions of at least \$300,000 in a year but less than \$550,000 are required to have financial statements reviewed. If contributions are \$550,000 or above, they must be reviewed by an independent CPA. Even if an organization does not meet those levels of contributions, or is otherwise exempt from having a charitable solicitation license, it may choose to secure an audit; many grant funders desire at least three years of audited financial statements be submitted with an application.
- **Balance Sheet and Other Financial Statements:** Depending on the size and complexity of the foundation, this activity may be conducted by a CEO, finance staff person or department, or members of the board, or it may be outsourced. Organizations may need to contact their accountant/auditor to determine the necessary financial statements, internal controls and policies they must develop.
- **Investment Policies and Managers:** While the board (investment committee) may be responsible for selecting appropriate investment policies and managers, foundation staff may also be involved in managing day-to-day interactions with investment advisors.
- **Insurance:** Foundations should maintain all necessary forms of insurance as appropriate for its staff, facilities and activities. Insurance policies may need to be updated based on periodic

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<sup>16</sup> This is a heuristic that most foundations follow, keeping below 2% ownership unless it is a passive investment entity, since the excess business holdings rules only apply to operating, non-functionally related businesses.

staffing and facility changes. Forms of insurance may include Directors and Officers Liability (D&O Insurance), Property, General Liability and unemployment insurance for any employees. Further, employment claims are typically the largest source of liability for nonprofit organizations, resulting in employment practice insurance typically being recommended. Given the increase in cyber attacks and ransomware, cyber security insurance is also advised. Consider discussing the foundation's various areas of potential risk with external advisors to secure appropriate types and amounts of insurance coverage.

## Legal and Tax Issues

- **Limits on Taxable Expenditures:** Per IRC Section 4945, a private foundation may be penalized for taxable expenditures, specifically those that do not follow legal requirements for grantmaking. Examples include grants for non-charitable purposes, funds spent on political campaigns and lobbying, improper procedures for grants to individuals, not following expenditures responsibility when required and not following necessary steps when making grants to certain categories of supporting organizations. Please note that while both **private foundations** and public charities are prohibited from political campaign intervention, private foundations are completely prohibited from lobbying (including as part of its grantmaking). Public charities may only conduct an “insubstantial amount” of lobbying.
- **Completion of the Form 990-PF or Form 990:** All grantmakers, whether private foundations or public charities must complete a Form 990 (including the Form 990-N or Form 990-EZ, depending upon income level) or Form 990-PF. Failure to file the Form 990 or 990-PF for three consecutive years will likely result in the IRS revoking the organization's tax-exempt status. Foundations must also keep all records used to show compliance with tax rules, as well as information reported on the IRS Form 990 or 990-PF.
- **Foundation Voluntary Termination/Dissolution:** Foundations intending to terminate operations have additional requirements beyond checking the “final return” box on its Form 990-PF or no longer filing its annual returns. Private foundations may voluntarily terminate their status by transferring their assets to one or more public charities and notifying the IRS of its intent to terminate, as well as filing its Form 990-PF for the final taxable year (including the final distribution). Failure to follow certain rules and procedures may result in termination taxes incurred on the organization. Any entity holding charitable assets must first receive consent from the State of Michigan Attorney General's Office before filing dissolution papers with the Department of Licensing and Regulatory Affairs (LARA). These organizations should engage qualified professional advisors and legal counsel to assist in termination activities, including fulfilling both federal and state requirements.
- **Complete Required State and Federal Filings:**
  - **Federal:**
    - **Form 990-PF Schedule B:** This document is required of **private foundations** that receive contributions of over \$5,000 in a given year.



- **Form 990-T:** This document is required of **private foundations** that have \$1,000 or more in gross income derived from unrelated business (known in the field as UBIT – Unrelated Business Income Tax).
- **Employment Tax Returns:** See the Human Resources section of this document.
- **State:**
  - **License to Solicit:** Organizations that fundraise must complete a License to Solicit through the State of Michigan. Depending on the level of funds raised, the State may require audited financial statements be part of the filing. (See the Fundraising and Donor Development section for further details.)
  - **Michigan Sales and Use Tax Certificate for Exemption:** Exemption from payment of sales and use tax on goods utilized for charitable purposes.
  - **State Corporate Filing and Income Tax:** State filings may be required for unrelated business income and employment taxes.
  - **State Sales and Use Tax:** Organizations selling tangible personal property (including items at auction for fundraising) may be required to charge and remit state sales tax. (In Michigan, the first \$10,000 of sales of tangible personal property in a calendar year for fundraising purposes are exempt from sales tax, as long as aggregate sales in the calendar year are less than \$25,000.)
- **Local:**
  - **Local Real and Personal Property Tax or Tax Exemption Filings:** Required tax filings are directly dependent on local rules and regulations.
  - **Local Business Licenses:** Depending on the organization’s activities, some localities require a license to conduct business, including charitable entities.

## Grantmaking and Programmatic Activities

- **Grantmaking:** While foundation boards typically approve all grants,<sup>17</sup> day-to-day grantmaking activity may be conducted by the board, grants committee or staff, depending on the size and complexity of the organization.
- **Grant Guidelines:** The foundation should create and periodically review its grant guidelines, outlining the types of grants and requirements associated with its grantmaking program. This information is generally available to external audiences, as it accompanies grant application materials.
- **Grant Application Forms and Process:** While the grant application may remain the same or similar over a period of time, it should be periodically reviewed by the board, a committee and/or staff to ensure it fits with the foundation’s grant guidelines and expectations, including those for due diligence. Board, committee and/or staff members may be responsible for reviewing completed applications as part of the grantmaking process.

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<sup>17</sup> National Standards requires that accredited community foundations have the board approve all grants. For other grantmaking organizations, the board may choose to delegate authority for grantmaking within certain defined parameters.



- **Site Visits:** If applicable, the foundation should have a process for site visits to grantees, including expectations of participating board and staff members. The organization should determine in advance under what conditions a site visit should be conducted, how often and by which person (staff or board member) affiliated with the foundation.
- **Grant Reports:** Each foundation varies widely in its respective reporting requirements and may differ between different grant programs. The organization should have an established process for grant reporting and evaluation, including a reporting form for grantees if applicable, a plan for how the information will be used and a protocol for the retention of these records.
- **Grant Policies:** Foundations may develop a number of internal policies around their grantmaking, depending on the nature and complexity of its grantmaking program and the number of individuals involved in it:
  - **Discretionary Grants:** Some foundations have an established “discretionary grants” program or budget designed to address urgent needs or specialized programs of interest to the foundation board or leadership.
  - **Disaster Grantmaking:** Similar to discretionary grants, this policy outlines under what conditions exceptional grants may be made to address disaster situations within the specific geographic region or issue area of interest to the foundation. This policy typically addresses the process to review and approve these grants.
  - **General Operating Support Grants and Other Categories of Grantmaking:** Foundations that have a number of different structures for their grantmaking program (operating, capital projects, etc.) should outline how these programs differ, including applications, processes, reporting, etc.
  - **Grants to Individuals:** Grants to individuals may include scholarships, educational travel or other charitable purposes. **Private foundations** making grants intended for travel or study (not basic needs) will need to have grantmaking pre-approved by the IRS. Records of individual recipients must be maintained, including names, addresses, grant purposes, selection process and any relationship with foundation officers or donors (which grants may be prohibited by the foundation’s conflict of interest policy and would be prohibited self-dealing in a private foundation). DAFs cannot make grants to individuals.
  - **Grants to Non-501(c)(3) Organizations:** Foundations should clearly outline whether or not they offer grants to non-501(c)(3) organizations and ensure this is consistent with their incorporation documents. Grants to these organizations oftentimes involve additional requirements and processes (i.e. expenditures responsibility), which should be outlined in this policy. **Private foundations** and DAFs have stricter requirements for expenditure responsibility in comparison to public charities, which may use it as best practice.
  - **Grants Supporting Legislative Activities:** Not all advocacy activity constitutes lobbying. However, public charities may only conduct an insubstantial amount of lobbying, and **private foundations** are prohibited from directly conducting lobbying activities and from

earmarking grant funds for lobbying, which oftentimes result in internal policies on the types of grants allowed to support legislative activities.

- **International Grants:** Foundations should clearly outline whether they make grants internationally, including under what circumstances and to which regions. **Private foundations** and DAFs making international grants must either exercise expenditure responsibility or make an equivalency determination, ensuring that funds are used for the IRS's definition of charitable purposes. Although not defined by the Internal Revenue Code, public charities must also ensure that funds granted internationally are used for charitable purposes and may want to follow the private foundation rules as best practice. In both cases, foundations must follow procedures to comply with OFAC, Patriot Act and similar laws aimed at preventing the funding of terrorism, and they must determine whether withholding of a portion of grant funds is required for tax purposes.
- **Multi-year Grants:** Foundations with multi-year grants should outline how these grants are processed and evaluated, including how these grants are reported for financial and database purposes. Even if accounting on an accrual basis, the organization cannot count multi-year grant dollars toward a private foundation's required 5% payout until they are transferred to the recipient organization.

## Fundraising and Donor Development

- **Charitable Solicitation License:** Within the state of Michigan, most 501(c)(3) organizations that solicit or receive donations of \$25,000 or more annually (or less than that amount if a contractor is paid for fundraising services, with some exceptions) are required to register to solicit within the state. (Other states have different rules and requirements to register prior to soliciting donors on behalf of a specific charitable entity within their jurisdiction.) This process requires submission of complete financial statements, a list of officers/directors and indication of methods of solicitation, contracts with professional fundraisers and a statement regarding the purpose for the use of donations.<sup>18</sup>
- **Engaging a Professional Fundraiser:** Each state has its own fundraising laws and may require registration or a solicitation license for consultants working in this space. Within the state of Michigan, contracts with professional fundraisers must be submitted as part of a nonprofit's charitable solicitation license application/renewal. Definitions of what constitutes a "professional fundraiser" may vary by state, with Michigan including consultants/contractors responsible for planning or managing campaigns and those responsible for phone or mail solicitation. Professional fundraisers soliciting in Michigan must be licensed and bonded prior to

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<sup>18</sup> To verify the charitable solicitation license status of a charity or public safety organization within the state of Michigan, visit: <https://www.ag.state.mi.us/CharitableTrust/frmDefault.aspx>. Please note that private foundations that exclusively receive funds from members, directors, incorporators, or members of the families of these parties (not from the general public) do not have to register for a charitable solicitation license within the state of Michigan.

engaging in this type of activity within the state.<sup>19</sup> If these individuals handle funds on a charity's behalf, they must file a campaign financial statement, reporting the funds raised, expenses, and the amount maintained by the charitable entity. This is a public document.

- **Donor Acknowledgement Letters:** In order for donors to take a charitable deduction for gifts of over \$250, they must secure a written acknowledgment of the gift from the charitable entity. Organizations usually assist donors by providing them the acknowledgement automatically. The acknowledgement must state that, “no goods or services were provided” in exchange for the contribution (unless it is a quid pro quo – see below). Gifts of property may require additional documentation. Unless the gift is cash, the value of the gift should never be stated by the recipient organization. Contributions to DAFs must also state that the foundation has “exclusive legal control” over the assets contributed.
- **Quid Pro Quo Donations:** Contributions are only deductible for the portion of the donation that does not cover other goods or services received by the donor (i.e., fair market value of items or benefits received, such as costs of a fundraising dinner, with some exceptions for low-cost token items). If donors receive something of tangible benefit in exchange for their contribution, then the foundation must provide the estimated fair market value of that quid pro quo within the donor acknowledgement letter.
- **Record Keeping:** Records should be maintained for contributions made to the organization, such as the fund agreement, bank record, titles to property or stock certificates, and the acknowledgment provided to the donor.
- **Donor Data and Privacy:** Foundations may choose to implement a donor data privacy policy or similar structure to ensure data is properly maintained, accessed and shared and to limit the number of personnel with access to donor data. The fundraising profession holds to the [Donor Bill of Rights](#) and [eDonor Bill of Rights](#) regarding concerns of donor data and privacy concerns.
- **Gift Acceptance Policy:** This policy should be periodically reviewed and updated to ensure that it fits with the evolving needs of the foundation and best practice in the field.
- **Donor Initiated Fundraising Policy:** This policy is required for community foundations that are accredited by National Standards.<sup>20</sup> It is also recommended for any charity that has volunteers or donors fundraising on the behalf of the organization or its component funds.
- **Charitable Gaming:** Many organizations engage in charitable gaming, such as raffles, bingo, charity gaming tickets, “millionaire parties” and auctions as a form of fundraising. These activities are highly regulated within the state of Michigan and require a license from the Michigan Lottery’s Charitable Gaming Division.<sup>21</sup> Rules in other states may vary.

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<sup>19</sup> To verify the license of a professional fundraiser in the state of Michigan, visit:

<https://www.ag.state.mi.us/CharitableTrust/frmDisclaimer.aspx>.

<sup>20</sup> For more information on donor initiated fundraising policies and other topics specific to community foundation funds, see “[Frequently Asked Questions About Fund Agreements](#)”.

<sup>21</sup> For more information, see CMF’s resource, “Charitable Gaming and Auctions for Grantmaking Foundations and Nonprofit Organizations,” available at: <https://www.michiganfoundations.org/resources/charitable-gaming-and-auctions-grantmaking-foundations-and-nonprofit-organizations>.

## Technology

- **Cybersecurity:** Relevant foundation staff should assess cybersecurity concerns related to use of the organization's technology, including by remote workers.
  - **Multi-factor Authentication (MFA):** Assigned staff should enable multi-factor authentication (MFA) on all systems and tools that support it. MFA requires that users provide more than one form of verification to access the organization's data or systems. Foundations may want to use an Authenticator App to manage MFA for multiple systems in a single app.
  - **Technology Audit:** Just like a financial audit, organizations may consider conducting a cybersecurity audit to ensure all areas of its networks are safe and secure, ideally on an annual or biennial basis. This audit should be conducted by a third party, not the organization's current IT support provider. An audit helps identify gaps in the institution's cybersecurity and an auditor can help develop an action plan for securing the organization's network, devices and software.
  - **Training:** The organization should regularly educate users on cybersecurity threats, such as through a cybersecurity training program like [KnowBe4](#). A strong training program can assist staff with flagging suspicious activity, identifying warning signs to watch for, and knowing procedures for reporting potential breaches.
  - **Geofencing:** Foundation policy should restrict login access to specific locations (i.e., U.S. only). Many systems will allow restricted access to systems, set preferred data storage locations and quickly eliminates hacking or other malicious activity trying to access the organization's systems from other countries. Relevant staff may allow temporary access if a staff member is working or vacationing outside the standard allowable geographic areas.
  - **Backups:** Many cloud systems do not offer traditional backups and may have only 30-day access to old data. If using Office 365 or Google GSuite, the foundation may consider using a third party backup tool to backup email and files stored in both systems. Assigned staff should confirm data backup policies for hosted products (i.e., CRM or GMS), including relevant backup schedule, retention of data, clarification of how to request access to a backup, turnaround time to acquire a copy/backup and the format the backup will be sent.
- **Databases and Organizational Systems**
  - **Customer Relationship Management (CRM) and Other Databases:** Most foundations use a CRM system or other database (even Excel) to manage information related to donors, vendors, grantees, etc.
  - **File Server:** Relevant staff should ensure folders and files are appropriately permissioned so only staff who need access to the data have it and to prevent exposing data to those who should not have it.
  - **Financial Software:** Foundation policy should ensure proper separation of duties and proper controls are in place to prevent fraud or accidental accounting errors, especially as it relates to financial software systems. Appropriate staff should work with the

organization's financial auditor to verify proper separation of duties across relevant financial system(s).

- **Grants Management Software (GMS):** This package may also include or scholarship and donor management tools, and other similar software. Appropriate staff should properly secure grantee data and restrict access to only those that need access to the information contained in the software. Internal policies should dictate that staff do not ask for more data than necessary and that the GMS should avoid storing highly sensitive data like social security numbers, bank accounts, credit cards, etc. If working with out-of-state applicants, other state and international data privacy laws may vary. For example, California and Europe (GDPR) have stricter requirements and instructions on how organization's handle a user's data or how to remove data if requested.
- **Log-in/User Management:** Foundations may consider implementing a user management system, as it removes in-office network dependency while allowing for remote access/administration to multiple systems. It can also allow the organization to track successful and unsuccessful login attempts. The organization may further consider implementing systems that support Single Sign-on (SSO), which allows users to login to multiple systems using a single set of credentials.
- **Payroll:** The foundation should implement security settings to avoid exposing important or private staff information, as well as establish appropriate approval processes for certain activities, such as time and attendance or reimbursements.
- **Policies**
  - **Data Privacy Policy (Internal and External):** An internal policy should instruct staff on expectations for keeping data and information private, data that can and cannot be shared and how it should be managed. External policy should outline how the organization uses data and, if applicable, other entities with which the foundation may share its data.
  - **Acceptable Use Policy:** This policy defines how staff are expected to use the technology, software and data, ensuring the expectation and use of the technology will be used for legal and ethical purposes, and outlines consequences.
  - **Data Ownership:** This policy defines all work conducted on behalf of the organization is owned by the organization.
  - **Data Retention Policy:** This policy defines the data and information held by the organization and outlines how long certain types of data must be kept legally or kept for business purposes. (See Record Keeping and Records Retention)
- **Digital and Paper Files:** The foundation may consider transitioning paper files to electronic records for easier access, search and security.
- **Devices:** Computers, cell phones, office phones and other network equipment should receive regular updates and be protected with anti-virus software, as necessary. The foundation should also consider a standard refresh/replacement cycle (recommended every 3-5 years) for technology devices provided to staff. Staff using personal phones or devices for foundation work should be required to use a lock screen/password and similar features to ensure the security of

the organization’s data. Relevant staff may also implement a guest Wi-Fi network for visitors (restricting access to the internet only), to ensure security of internal files on the institutional network.

## RECOMMENDED RESOURCES

Council of Michigan Foundations. “Sample Documents Hub.”

[www.michiganfoundations.org/sampledocs](http://www.michiganfoundations.org/sampledocs).

Exponent Philanthropy. “Annual Board To-Dos: A Checklist for Running a Foundation.”

<https://www.exponentphilanthropy.org/resource/annual-board-to-dos-a-checklist-for-running-a-foundation/>.

Internal Revenue Service. “Compliance Guide for 501(c)(3) Private Foundations.”

<https://www.irs.gov/pub/irs-pdf/p4221pf.pdf>.

Internal Revenue Service. “Compliance Guide for 501(c)(3) Public Charities.”

<https://www.irs.gov/pub/irs-pdf/p4221pc.pdf>.

Nober, Jane C. “Check This: A Compliance Checklist for Private Foundations.” Council on Foundations.

<https://www.cof.org/sites/default/files/documents/files/Check-This--A-Compliance-Checklist-for-Private-Foundations.pdf>.

## ABOUT ASK CMF

This document was authored by Brittany Kienker, Ph.D., Knowledge Insights Expert in Residence for the Council of Michigan Foundations (CMF). Legal aspects of this document were reviewed by Jennifer Oertel, outside legal counsel to CMF. CMF members can find answers to their most pressing questions through CMF’s Knowledge Insights division, including Ask CMF, the Knowledge Center and the Sample Documents Hub. Ask CMF is a free service to CMF members, available through the “Ask CMF” link on the CMF homepage or by visiting <https://www.michiganfoundations.org/practice/ask-cmf>.

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