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March 23, 2005

Kari Pardoe
Council of Michigan Foundations
Suite 3, One South Harbor Avenue
P.O. Box 599
Grand Haven, MI 49417

Re: Grand Rapids Community Foundation

Dear Kari:

The Grand Rapids Community Foundation has asked whether it is permissible for its youth trustee to be eligible for scholarships granted by the Foundation. The Foundation currently appoints a youth trustee to its Board of Trustees. Under the Foundation's conflicts of interest policy, the youth trustee is not eligible for scholarships granted by the Foundation. The Foundation has asked whether it is legally permissible for its youth trustee to apply for and receive a scholarship granted by the Foundation.

The youth trustee may be a recipient of a scholarship from the Foundation so long as neither he or she nor any family member participates in the consideration of scholarships for any candidates in the pool of applicants.

The issues are whether the granting of the scholarship to the youth trustee is considered a private benefit under Section 501(c)(3) of the Internal Revenue Code (the "Code") or an excess benefit transaction under Section 4958 of the Code.

The Internal Revenue Service considered these issues in Private Letter Ruling 200332018. The facts considered by the Service are as follows:

A private foundation made a grant to a nonprofit corporation classified as a supporting organization with a number of colleges and universities being the supported organizations. The grant was used to establish a scholarship program. Nominees for scholarships under this program were submitted to the supporting organization by community foundations around the state. Several community foundations indicated that community volunteers resigned from positions on their boards and committees because they feared that the excess benefit transaction restrictions and general private benefit limitations under Section 501(c)(3) of the Code might disqualify their children, grandchildren and other relatives from consideration as nominees for

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scholarships regardless of the degree of their personal involvement in the identification of potential scholarship recipients. Both the supporting organization and the community foundations establish rules that whenever a community foundation's pool of potential scholarship nominees included a family member of the community foundation's directors, officers or nominating committee members, that director, officer or nominating committee member must recuse him or herself from the entire scholarship nominating process for that pool of applicants including all meetings, discussions, debates and votes regarding nominations, and that the recusal be documented by the community foundation.

The Service first considered whether the granting of a scholarship to a family member of a director, officer or member of a nominating committee would constitute a prohibited private inurement or private benefit to an individual. Under Section 501(c)(3) of the Code, for an organization to be exempt from tax it must be operated exclusively for religious, charitable, educational or other specific exempt purposes and that no part of the net earnings may inure to the benefit of an individual. The regulations under Section 501(c)(3) provide that the advancement of education is included in the term "charitable" and that the granting of scholarships based on scholastic ability does not preclude tax-exempt status. Citing Rev. Rul. 56-403, 1956-2 C.B. 307, the Service noted that the limitation of scholarships to a particular group does not vitiate tax-exemption because there is no specific designation of persons eligible for scholarships and the purposes of the foundation are not so personal, private or selfish in nature as to lack the elements of public usefulness and benefit.

In applying its analysis to the facts of the private letter ruling, the Service held that the awarding of the scholarships contributed to the advancement of education and were therefore charitable activities within the meaning of Section 501(c)(3). In addition, the guidelines for the scholarship program were designed to insure that no director, officer or member of the nominating committee of a community foundation could take advantage of his or her position to benefit from the selection of scholarship recipients. Even though scholarships might be granted to relatives of community foundations' directors, officers or nominating committee members, the scholarships benefited a charitable class and therefore such awards did not result in prohibited private inurement or a private benefit to any individual and would not jeopardize the community foundation's tax exempt status.

The Service then considered two issues with respect to the application of the excess benefit transaction rules - first, whether the grant of the scholarships qualified for an exception to the excess benefit rules and second, whether the officers, directors and nominating committee members are disqualified persons in light of the requirement that they recuse themselves from any participation in the nominating process when a family member is involved. The Service did not issue a ruling with respect to these issues but did issue a general information letter calling attention to well-established principles of tax law.

The Regulations provide an exception to an excess benefit transaction, namely that the economic benefit is disregarded if the benefit is provided to a person solely because the person is a member of a charitable class that the public charity intends to benefit in pursuing its exempt purpose (Reg. Sec. 53.4958-4(a)(4)(v)). Based on this exception, the Service concluded that the

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scholarships were awarded solely because the recipient is a member of a charitable class that the foundation intended to benefit through the scholarship program. Accordingly, a relative of a current or former director, officer or nominating committee member of the community foundation would be considered a scholarship recipient solely because he or she was a member of the charitable class that the scholarship program intended to benefit.

Further, the Service concluded that the community foundation directors, officers and nominating committee members and their relatives were not disqualified persons since any person with a relative eligible for consideration for a scholarship must recuse him or herself from the entire nominating process with respect to that pool of potential nominees including all meetings, discussions, debates and votes regarding nominations. This is analogous to the recusal of a board member when his or her compensation agreement is under consideration. In particular, the regulations provide that a member of the board of directors will not be treated as such when the board is reviewing the member's compensation package if that member recuses himself or herself from that meeting and is not present during the debate and voting on the compensation arrangement (Reg. Sec. 53.4958-6(c)(1)).

Although a private letter ruling is directed only to the party requesting it and may not be cited as binding precedent, nevertheless private letter rulings provide helpful guidance concerning the position of the Service on the issues under consideration.

Based on the reasoning set forth in the Private Letter Ruling, the awarding of a scholarship to a youth trustee would not constitute either a private benefit or an excess benefit transaction. The youth trustee may participate in the scholarship program if he or she and any of the youth trustee's family members recuse themselves from the entire nominating process with respect to the pool of potential nominees in which the youth trustee is included. The youth trustee and any of his or her family members must be excluded from the entire process including all meetings, discussions, debates and votes regarding the nominations, and that recusal must be documented.

If the Grand Rapids Community Foundation wishes to include a youth trustee in the pool of applicants, its conflict of interest policy should be modified to allow the youth trustee and any of his or her family members to recuse themselves as set forth in the regulations.

If you have any questions, please contact us.

Very truly yours,

CLARK HILL PLC



David E. Nims

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