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"INSIDERS" AND "DISQUALIFIED PERSONS" – MEANING AND PROTECTIVE MEASURES

Key to understanding many of the restrictions affecting public charities and private foundations is having an understanding of the term *insider* and *disqualified person*. There is a legal difference between these two terms; for example, the *disqualified person* terminology is used in the excess benefit transactions and private foundations context (see table on next page) to describe an *insider*. However, for most tax exempt organizations, the terms can be used interchangeably.

Generally speaking, people or entitles determined to be insiders or disqualified persons are sometimes prohibited from entering into certain types of transactions with the tax exempt organization. To generally understand the concept, this description may help:

> *An insider or disqualified person is someone with significant influence over the organization. The concern is that the disqualified person causes the organization (either through direct control or through influence) to make decisions that are not based exclusively on the organization's charitable activities, but instead are colored by the person's private interests.*

Insiders or disqualified persons may include: the creators of the tax exempt organization; substantial contributors to the organization; officers, directors and trustees of the organization; employees with the authority to make administrative or policy decisions on behalf of the organization; and certain family members of all of the above. This is not an all inclusive list, but it identifies the ones most important for most tax exempt organizations (see the table further below for more specificity).

Excluded from the *insider* or *disqualified person* categories are people or entities who lack the authority to make administrative or policy decisions for the foundation. These include, among others: lawyers, accountants, or investment advisors acting in that capacity, and public charities. In other words, these people may be able to enter into certain transactions with the organization that an insider or disqualified person could not, at least not without being potentially subject to sanctions.

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Bottom line rule: *Know who potential insiders or disqualified persons are and get legal advice before the tax exempt organization enters a transaction with them.*

The table below provides greater detail on who may be identified as a disqualified person (***pay special attention to the definition of a substantial contributor; also,*** this is a complicated area and the table is not all encompassing).

DISQUALIFIED PERSONS
The following persons or entities are considered disqualified persons: • *Substantial contributors* – Includes donors whose cumulative contributions to the foundation (for all years from inception, and including their spouse's donations) are greater than 2% of the foundation's cumulative donations from all sources (for all years from inception). For example, if cumulative donations to the foundation are less than $250,000, then any donor giving more than $5,000 is a *substantial contributor*. Evaluation is based on the cumulative donations at the end of the tax year. **Once a substantial contributor, always a substantial contributor**, except in limited cases where 10 years has elapsed since the person made a donation (plus a number of other conditions). In the case of a trust, the creator of the trust is a substantial contributor, regardless of amount donated. Note: in some cases although a person/entity is determined to be a substantial contributor and therefore a disqualified person, there may be an exception that permits certain transactions to occur without violation. For example, a public charity that is a substantial contributor to a private foundation, is exempt from the self dealing rules (discussed further below). • *Foundation managers* – Includes officers, directors, and trustees of the foundation who have authority to make administrative or policy decisions for the foundation. Also may include in certain situations key employees (persons having responsibilities, power, or influence over the organization as a whole similar to those of officers, directors, or trustees, such as executive directors or chief financial officers, etc.). • *Twenty percent owners* – Includes a person who has 20% of the combined voting power in an organization (such as a partnership, corporation or trust) which is deemed a substantial contributor to a foundation. • *Family members* – Persons related to substantial contributors, foundation managers and twenty percent owners also fall within the disqualified person category. For the purposes here, a "family member" includes: (1) an individual's spouse; (2) ancestors; and (3) children (including adopted ones), grandchildren, great-grandchildren, and their spouses. **Brothers, sisters, aunts, uncles, nephews and nieces are *not* included.** • *Corporations, Partnerships, Trusts, Estates* – If substantial contributors, foundation managers or family members have more than a 35% voting power in a corporation or partnership, or more than a 35% beneficial interest in a trust or estate, then the organization, trust or estate also is deemed a disqualified person. • *Private Foundations* – may be considered disqualified persons in the limited circumstance of excess business holdings rules (discussed further below). This situation would only arise where the two foundations own more than 20% of a business. • *Government Officials* – may be considered disqualified persons but only for purposes of self dealing rules. Only certain kinds of government officials are included (such as persons elected to certain federal positions)

While officers and directors are easily identified, a substantial contributor might not be. One protective step would be for the tax exempt organization to create a yearly report that identifies *substantial contributors*. This report would provide the cumulative donations to the tax exempt organization, the aggregate donations of a specific donor in a given year, and whether this donor was under or over the $5,000/2% threshold (discussed in the table below), thereby helping to identify persons, who through their charitable giving, become insiders or disqualified persons.