Building a Township Foundation: 501(c)(3) Formation, Governance, and Best Practices

Township Officials of Illinois (TOI)

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Springfield, Illinois

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TODAY'S AGENDA

- Why and When
- Legal Structure
- Forming the Foundation
- Charitable Purposes
- Governance Best Practices
- Township Issues
- The MOU



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TOWNSHIP CODE

- Townships have only the powers expressly granted to it by statute
- The **Township Code** provides townships the power to:
  - Acquire by gift and hold property for the use of their residents (60 ILCS 1/85-10)
  - Grant funds to non-profit entities for:
    - Public safety
    - Environmental protection
    - Public transportation
    - Health
    - Recreation
    - Libraries
    - Social services for the poor and aged

(60 ILCS 1/85-13)

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DILLON'S RULE

- The Township Code **does not** provide townships the power to establish or operate foundations
- Therefore, townships **do not** have the power to establish foundations under Illinois law
- The Foundation does not "belong" to the township!
  - ***But, consistent with its mission to help to advance the plans and objectives of the township, the foundation should actively collaborate with the township***



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INSTEAD…

Township Foundations are typically:

- Separate legal entities
- Formed under the Not-for-Profit Corporation Act
- Tax-Exempt under IRS Code § 501(c)(3)
- Subject to articles of incorporation and by laws
- Governed by independent board of directors
- What does the “foundation” actually refer to?

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LEGAL CONCERNS

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Legal Concerns

- Prohibited Interests
- Tax-Exempt Status
- Conflicts of Interest
- Piercing of the Corporate Veil

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PROHIBITED INTERESTS

State law prohibits public officials from:

- Being **directly or indirectly interested** in any matter on which they may be called upon to vote.
- **Representing** any person or entity in any bid or contract proposal on which they may be called upon to vote.



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50 ILCS 105/3(F)

- Effective January 1, 2024
- Amends Section 3(f) of the Public Officers Prohibited Activities Act to allow township officers to:
  - **Serve** on not-for-profit corporation boards
  - **Actively vote** on matters involving the not-for-profit corporation **and** the township **if appointed** by the town board to represent its interests



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Tax-Exempt Status

The foundation must be organized and operated exclusively for:

- Charitable purposes
- Educational purposes
- Scientific purposes
- Religious purposes
- Literary purposes



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Tax-Exempt Status

The foundation must operate only for the purposes set forth in its application for tax-exempt status and bylaws



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Tax-Exempt Status

No “private benefit” or “private inurement” of income or assets to:

- Foundation incorporators, directors, officers, or employees
- Substantial contributors to the foundation
- Township or other government officials or employees
- Private inurement = when nonprofit assets are devoted to benefit insiders



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Tax-Exempt Status

No use of funds or assets for lobbying or political activity

- Cannot advocate for or against legislation
- Cannot campaign for or against a candidate for political office



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Tax-Exempt Status

Non-exempt and other prohibited activities can result in:

- Tax liability for the foundation and/or donors
- Penalties, interest, and other sanctions
- Revocation of the foundation's tax-exempt status

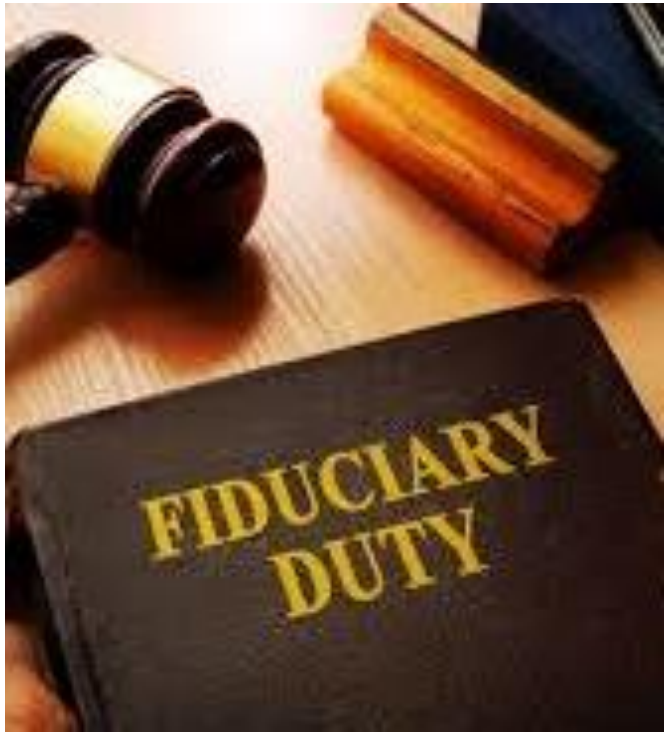


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Conflicts of Interest

Directors and officers owe the foundation a duty of loyalty

- They must act in the best interests of the foundation
- They may not act solely for the benefit of themselves or others



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Conflicts of Interest

Directors and officers cannot divert foundation assets, opportunities, or information for the benefit of:

- Themselves or other “insiders”
- Township and other government officials or employees
- Donors or other “interested” parties



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Conflicts of Interest

A breach of the fiduciary duty of loyalty may result in:

- Rescission of contracts, disgorgement of profits, and/or restitution
- Personal liability for compensatory damages, punitive damages, and/or attorneys' fees and court costs



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Conflicts of Interest

Directors and officers have the burden of proof to show the transaction was fair!

- Even if the conflict was disclosed
- Even if the director or officer did not participate in the decision



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PIERCING THE CORPORATE VEIL

Generally, the law treats a corporation as separate legal "persons" that is **solely responsible** for its debts and liabilities

- Liability is **limited** for directors, officers, and affiliated entities
- Claimants can collect only from the corporation's assets



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Piercing the Corporate Veil

Courts will hold other persons or entities liable for a corporation's actions:

- For failing to observe **corporate formalities**
- To prevent **injustice** or **fraud**



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Piercing the Corporate Veil

Factors which courts consider when determining whether or not to pierce the corporate veil include the following:

- **Commingling** of funds, assets, and personnel
- Failure to maintain **arm's length** relationships
- Absence or inadequate **corporate records**
- Failure to observe **corporate formalities**
- **Non-functioning** corporate officers and directors

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PIERCING THE CORPORATE VEIL

If the foundation's "corporate veil" is pierced:

- Its directors, officers, and affiliated entities (such as the township) may be **subject to liability**
- **No immunity** for private foundation



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FOIA & OMA



All “public records” and “public bodies” are presumed to be subject to FOIA & OMA

- “Public records” and “public bodies” are broadly construed
- The public body has the burden of proving an exemption applies by clear and convincing evidence

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"PUBLIC RECORDS"

"Public Records" means all records pertaining to the transaction of public business:

- Having been **prepared by or for** any public body; or
- Having been or being **used by, received by, in the possession of, or under the control of** any public body.

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"PUBLIC BODY"

"Public body" includes:

- All legislative, executive, administrative or advisory bodies of townships of the State of Illinois; and
- Any **subsidiary bodies** of any of the foregoing, including, but not limited to, committees and subcommittees which are **supported in whole or in part** by tax revenue, or which **expend tax revenue**.

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FOIA & OMA

Courts have relied heavily on the specific facts and circumstances of each case in determining whether foundations are "public bodies" and whether foundation records are "public records"

- If a foundation is found to be a "subsidiary body," it will be subject to OMA's notice, agenda, public comment, and minutes requirements
- If a foundation's records are found to have been "prepared for," "received by," or "under the possession or control" of a public body, they will be subject to FOIA
  - Donor records? Exemptions?

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This Is Real: Recent FOIA / PAC Examples

- Recent PAC matters involved requests for foundation donor information and foundation draft bylaws.
- Those requests raised questions about whether foundation-related materials in Township possession could be subject to FOIA.
- Donor privacy and internal governance materials became live issues.

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PRACTICAL FOIA RISK AREAS

- Donor lists and donor identities.
- Draft bylaws and internal governance documents.
- Records held by Township personnel serving dual roles.
- Records created, received, used, or controlled by the Township.
- Public perception risk even where the Foundation is legally separate.



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THE COURT OF LAW



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THE COURT OF PUBLIC OPINION



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BEST PRACTICES

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Best Practices

- Corporate Governance
- Personnel
- Facilities & Assets
- Financing
- Accountability

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FILING OBLIGATIONS

Foundations are recognized non-profit entities and therefore, must file certain forms with state and federal authorities

- **Illinois:** may need to register as a charity with the Illinois Attorney General's Charitable Trust Bureau
- **IRS:** should obtain EIN and 501(c)(3) status with IRS, will need to file annual return (990, 990-EZ, or 990-N)



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PUBLIC INSPECTION

Tax-exempt organizations must make annual returns and exemption applications filed with the IRS available for public inspection and copying (Treas. Reg. 301.6104(d)-3)

- Application, Form Series 1023 or 1024
- Annual Return, Form Series 990 (no K-1)
- Alternative: Posted on website
- $20 per day penalty



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CORPORATE GOVERNANCE

Foundations must be **separately organized** and maintain **legal independence** from the township

- Foundations should have **no** formal or legal role in the **governance** of the **township**
- Townships should **not** have a formal or legal role in the **governance** of the **foundation**



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FOUNDATION BOARDS



The township **should** have representation on the foundation's board because of its official connection to the township

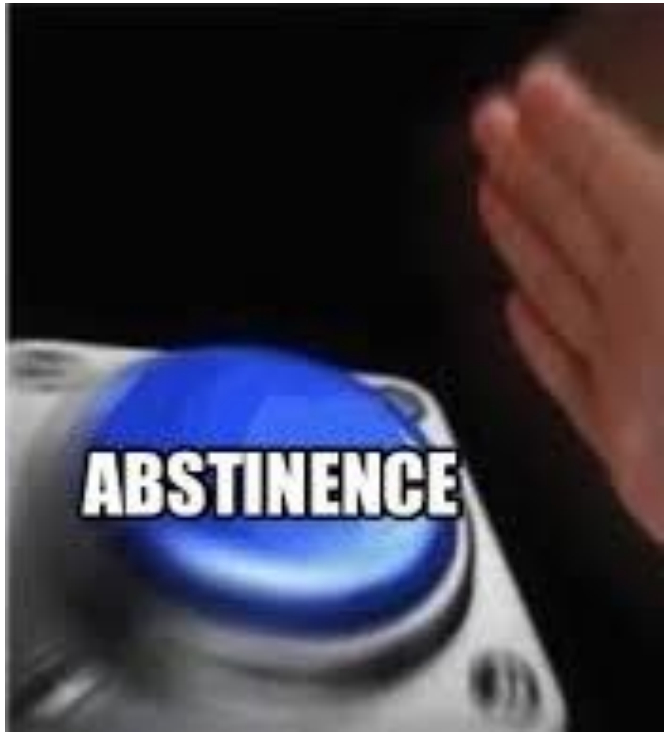
- The foundation board should include a **cross section** of township officials, staff, residents, and other community representatives
- The number of township personnel should be kept to a **minimum**
  - Preferably, no more than 3

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FOUNDATION BOARDS

Township **officials** and **employees** who serve on foundation boards should:

- Serve only as ***ex officio***, **non-voting** members of the foundation board
- **Disclose** their "interest" in the foundation at **township board meetings**
- **Abstain** from voting on matters related to the foundation at **township board meetings**



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FOUNDATION BOARDS

The foundation may have **membership or nomination committees** for nominating board members

- An *ex-officio* member **may nominate** individuals for board membership
- But, the **final decision** should be the prerogative of **voting members**



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ARTICLES & BYLAWS



Review the foundation's articles of incorporation and bylaws

- Stated purposes must be tax-exempt
- The role in supporting the township's mission should be clearly defined
- ***Operations must be consistent with stated purposes***

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ARTICLES & BYLAWS



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ARTICLES & BYLAWS



The foundation's bylaws should address:

- Board and membership composition
- Selection of directors and officers
- Roles and responsibilities
- Meeting, quorum, and voting requirements
- Conflicts of interest
- Compensation and indemnification
- Amendments and Dissolution

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Articles & Bylaws

Review them regularly!

Tailor them to your mission and needs!

Follow them always!



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PERSONNEL

It is preferred that foundation personnel and township personnel be kept **separate**

- **Foundation** personnel should be hired, supervised, and paid solely **by the foundation**
- **Township** personnel should be hired, supervised, and paid solely **by the township**



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PERSONNEL

Dual-role personnel should be kept to a **minimum** and must be **managed** to minimize potential conflicts

- Such personnel should **strictly account for time** working for the township vs. for the foundation
- Township personnel should **not** perform services for the foundation **while on duty** with the township



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PERSONNEL

In most cases, **direct payment** by the foundation to township personnel should **not be permitted**

- With approval of the foundation board, the foundation **may** fund a portion of a township employee's salary
- Such funds should be **deposited with the township** and then **used by the township to pay the individual**
  - The foundation should be acknowledged as the source of funds

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FACILITIES & ASSETS

Ideally, foundations should have **its own** facilities, equipment, and assets

- The **township** should **not gift or loan** equipment or other assets to a foundation
- Dual-role and other foundation personnel should **not use township resources** for foundation business
  - E.g., office space, vehicles, equipment, computers, cell phones, e-mail accounts, and office supplies



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FACILITIES & ASSETS

If the township makes space or other assets available to the foundation, a **formal agreement** should be established

- The agreement should **specify the payments or other remuneration** by the foundation
- Monetary or in-kind payments should be documented by the township at the fair market rate



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USE OF TOWNSHIP NAME & LOGO

A foundation may represent its **association with** a township by use of the township's name, symbol, or logo

- Township names are generally considered part of the public domain and not entitled to trademark protection
  - Confusion or mistaken beliefs?
  - Case-by-case determination
- Township logos may be entitled to legal protection and may be registered as a trademark

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Finances & Accountability

In general, **townships** should **not** transfer, gift, or loan public funds to foundations

- Township funds are **public funds** (regardless of the funding source)
- Townships **may** make public funds available to the foundation only in exchange for **specific** services or other consideration

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FINANCES & ACCOUNTABILITY

Commingling of foundation funds and township funds must be strictly prohibited

- Criteria for determining if gifts are directed to the foundation or the township should be clearly established
- Separate financial accounts must be maintained at all times



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FINANCES & ACCOUNTABILITY

When funds are donated to the foundation, it is important to understand that the intent of the donor may be to give to projects of the township

- However, only the foundation board can approve a transfer of foundation funds to the township
- The township should have no authority to direct the foundation to transfer funds to the township

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FINANCES & ACCOUNTABILITY

The foundation should be **audited** on an annual basis by an independent CPA firm

- The foundation should cooperate with the township's auditors in carrying out their auditing function for the township
- The township should cooperate with the foundation's auditors by providing any information needed for performance of the audit



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FINAL THOUGHTS – SEPARATION

Legal separation is critical to minimizing risk



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Final Thoughts – Collaboration

However, frequent collaboration is also essential to:

- Clearly defines the relationship and establish boundaries between the township and the foundation
- Ensure the preservation of the mission alignment between the township and the foundation stays intact over time



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The MOU: Where Best Practices Become Operable

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THE MOU MUST AVOID CREATING

- Township ownership of the Foundation
- An agency relationship
- A partnership or joint venture
- Joint employment
- An “alter ego” relationship
- Township control of Foundation assets



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WHY HAVE AN MOU?

- Define the relationship.
- Preserve legal independence.
- Document permitted collaboration.
- Reduce ambiguity.
- Create accountability.



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Core Theory of the Deal

- The Foundation is a legally established, independently governed 501(c)(3).
- The Township and Foundation share a common public-serving mission.
- They may collaborate and share certain services and resources.
- Any sharing of services, space, support, or resources should be on terms consistent with fair market value.

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Use of Township Space and Resources

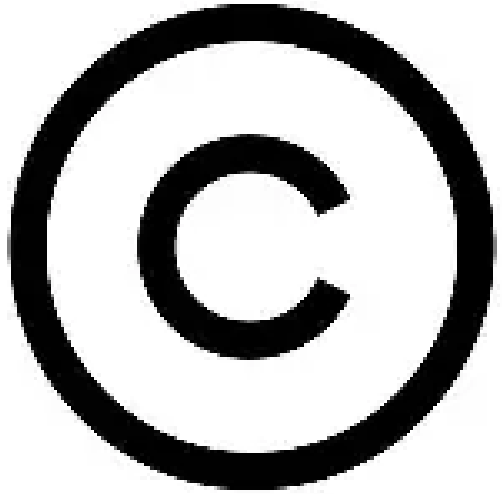
- Office or meeting space should be provided only under a formal agreement.
- Shared office resources should be specifically identified.
- Building access and use rules should remain under Township control.
- Alterations and signage should require approval.
- The Foundation should pay for space and resources at fair market value or other documented consideration.



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USE OF TOWNSHIP NAME AND MARKS

- Any use of the Township's name, logo, or marks should be licensed expressly.
- The license should be limited, revocable, and for defined purposes only.
- Use should remain subject to Township approval and branding controls.
- The right to use the Township's identity can be revoked for misuse, reputational harm, or deviation from approved purposes.



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SHARED EMPLOYEE SERVICES

- Any Township employee assistance should be by request and subject to Township approval.
- Township employees remain Township employees at all times.
- Time spent on Foundation matters should be tracked carefully.
- The Foundation should reimburse the Township for wages, benefits, and payroll costs attributable to Foundation work.
- Direction, supervision, and risk allocation should be addressed expressly.



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Money Flow Must Be Explainable

- Monthly invoicing and reimbursement.
- Document all payments for space, support, staffing, and other shared resources.
- No commingling of Township and Foundation funds.
- Separate accounts at all times.
- Audit and reporting cooperation.



Every shared resource should have a paper trail.

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Insurance, Indemnity, and Risk Allocation

- Foundation insurance requirements.
- Additional insured status where appropriate.
- Indemnification for Foundation activities and use of Township resources.
- Risk allocation for shared personnel and use of facilities.
- Default, remedies, and termination concepts.



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What the MOU Should Also Say the Relationship Is Not

- Not an agency relationship.
- Not a partnership.
- Not a joint venture.



- Not Township ownership or control of the Foundation.
- Not a basis to disregard separate legal identity.

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MOU Yes — But Draft It Carefully

- An MOU is a best-practices tool.
  - It should not be drafted so broadly that it makes the Foundation look like the Township's alter ego, agent, or mandatory fundraising arm.
  - The MOU should focus on boundaries, resource sharing, reimbursement, accountability, and aligned but separate operations.



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FINAL THOUGHTS – MOU

Consider a formal Memorandum of Understanding to set forth:

- The parties' legally independent nature and common purposes
- Services and support to be provided by the respective parties
- Terms and conditions for use of personnel, facilities, and assets
- Obligations with respect to accounting, reporting, and audits
- Policies and controls for conflicts of interest and improper benefits



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Strengthening the Foundation Without Losing It



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The Real Tension

Too Much Overlap

- Conflict risk
- Commingling risk
- FOIA/OMA exposure
- Veil-piercing / alter ego arguments.

Too Much Separation

- Mission drift
- Succession problems
- Loss of alignment
- Foundation resistance to Township-supported initiatives.

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The Goal Is Not Maximum Separation

- Not Township control.
- Not total detachment.
- Legally separate.
- Operationally aligned.
- Independent board, shared mission.
- Boundaries on paper, relationships in practice.



Legally Separate. Operationally Aligned.

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How to Reduce Drift

1. Contractual Leverage:

- condition use of Township name/marks, space, and support on appropriate cooperation and compliance; use the MOU to reinforce accountability and boundaries.

2. Board Stewardship:

- select mission-aligned, trustworthy board members; focus on continuity, judgment, and stewardship; avoid allowing the Foundation to drift away from its intended public-serving purpose.

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QUESTIONS?



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