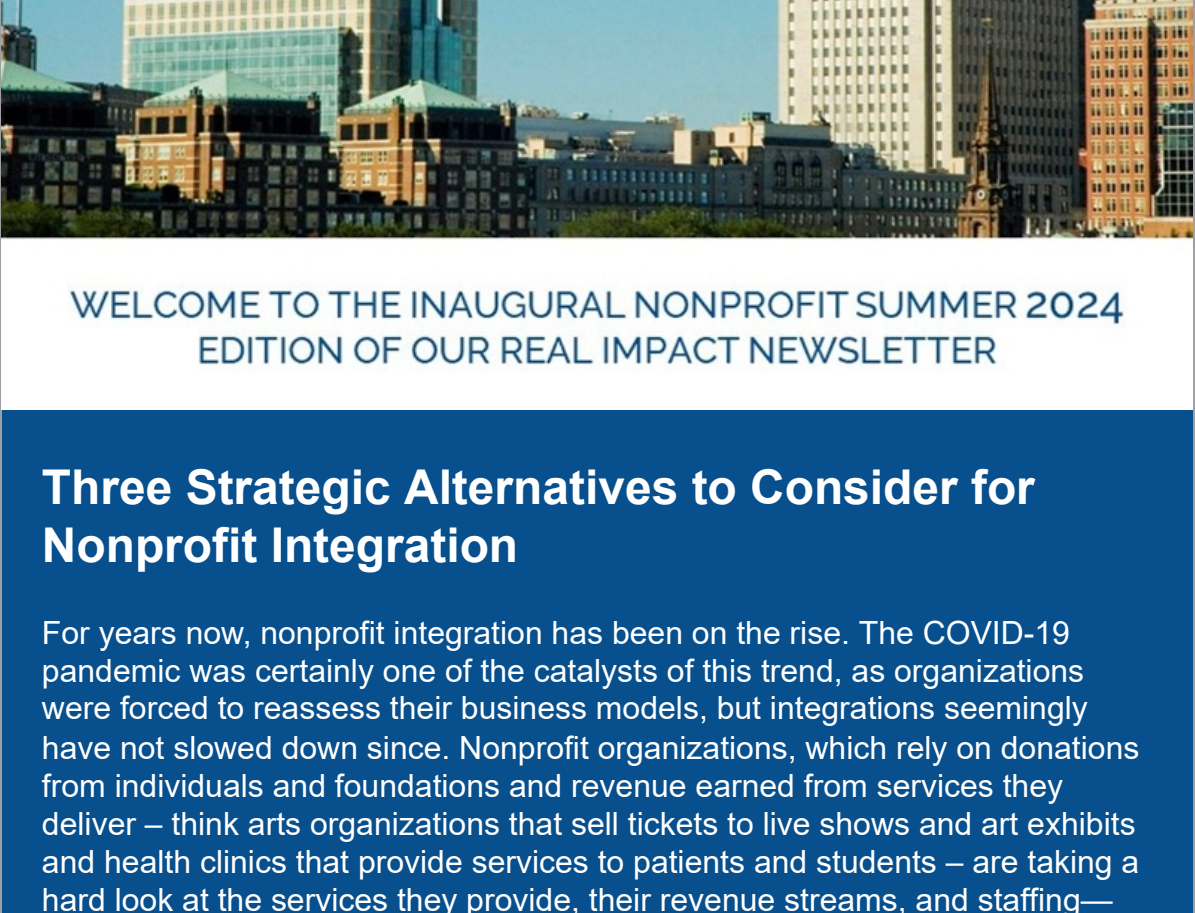




# THE REAL IMPACT



WELCOME TO THE INAUGURAL NONPROFIT SUMMER 2024 EDITION OF OUR REAL IMPACT NEWSLETTER

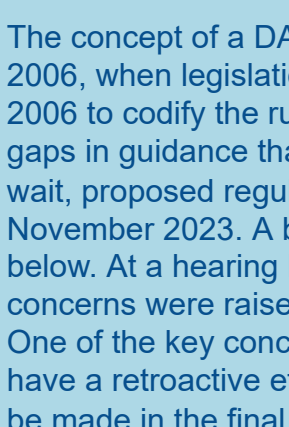
## Three Strategic Alternatives to Consider for Nonprofit Integration

For years now, nonprofit integration has been on the rise. The COVID-19 pandemic was certainly one of the catalysts of this trend, as organizations were forced to reassess their business models, but integrations seemingly have not slowed down since. Nonprofit organizations, which rely on donations from individuals and foundations and revenue earned from services they deliver – think arts organizations that sell tickets to live shows and art exhibits and health clinics that provide services to patients and students – are taking a hard look at the services they provide, their revenue streams, and staffing—among other—costs. One way to deal with challenges in these areas is to collaborate with other organizations in a way that allows all constituencies' needs to continue to be met.

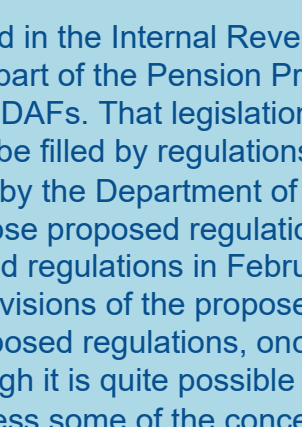
Below is a chart that summarizes the key features of, and differences between, the three main options nonprofits should be considering when undergoing a strategic alternatives exercise, from a less integrated model on the left to a more integrated model on the right: (1) entering into a management agreement, (2) establishing a sole member relationship, and (3) merging.

← LESS INTEGRATED	↔	MORE INTEGRATED →
Option #1: Management Agreement	Option #2: Sole Member	Option #3: Merger
<p><b>Key Attributes:</b></p> <ul style="list-style-type: none"> <li>Contractual relationship</li> <li>Organizations remain legally independent and in existence</li> <li>Relationship may be terminated upon mutual agreement and there is often a set expiration</li> <li>Arrangement whereby operational and managerial control of one organization is vested in another</li> </ul>	<p><b>Key Attributes:</b></p> <ul style="list-style-type: none"> <li>One organization—typically the larger one—becomes the corporate sole member of the other organization</li> <li>Creates a structure similar to a parent/subsidiary structure</li> <li>Parent organization typically has the right to elect board members and vote on certain fundamental transactions of sub organization</li> </ul>	<p><b>Key Attributes:</b></p> <ul style="list-style-type: none"> <li>Most integrated of the options</li> <li>Legal existence of one organization in a merger completely goes away</li> <li>One legal entity after the merger</li> <li>Assets and liabilities become those of the surviving entity</li> </ul>
<p><b>Pros:</b></p> <ul style="list-style-type: none"> <li>Combination of certain functions provides for cost-saving</li> <li>Defined period of time</li> <li>Two separate entities maintaining separate programs and liability protection</li> <li>Ways for smaller organizations to get support from larger, highly staffed organizations</li> </ul>	<p><b>Pros:</b></p> <ul style="list-style-type: none"> <li>Liability protection/isolation between the two entities</li> <li>Activities of both organizations can stay compartmentalized</li> </ul>	<p><b>Pros:</b></p> <ul style="list-style-type: none"> <li>Combines administrative and similar costs, often resulting in cost-saving post-merger</li> </ul>
<p><b>Cons:</b></p> <ul style="list-style-type: none"> <li>Ongoing administration and compliance for both organizations (e.g., state filings, federal tax filings, entity financial reporting, employment matters)</li> </ul>	<p><b>Cons:</b></p> <ul style="list-style-type: none"> <li>Ongoing administration and compliance (e.g., state filings, federal tax filings, entity financial reporting, employment matters)</li> </ul>	<p><b>Cons:</b></p> <ul style="list-style-type: none"> <li>Liabilities of entity going away become liabilities of the surviving organization</li> </ul>
<p><b>Other Similar Options:</b></p> <ul style="list-style-type: none"> <li><b>Resource Sharing Agreement</b> – agreement to collaborate in defined ways, such as with respect to certain employees or administrative functions</li> <li><b>Service Agreement</b> – One or both parties provides services (with respect to programming, for example) to the other</li> </ul>	<p><b>Other Similar Options:</b></p> <ul style="list-style-type: none"> <li>Could also create one overarching management entity with separate operating entities underneath</li> </ul>	<p><b>Other Similar Options:</b></p> <ul style="list-style-type: none"> <li><b>Consolidation</b> – a new entity is formed and both organizations are merged into the new entity; this option may make sense for the combination of “equals” when the desired perception is that neither has advantage over the other</li> <li><b>Asset sale</b> – the surviving entity picks and chooses which assets and liabilities (if any) to purchase from the other entity and the other entity then goes through a dissolution process; this option is desirable if there are liabilities that the surviving entity does not want to assume</li> </ul>
<p><b>Traps for the Unwary:</b></p> <ul style="list-style-type: none"> <li>Charities are limited or restricted from certain activities, so if one of the organizations is not a charity, care must be taken to ensure charitable funds are not being used to fund non-charitable activities</li> </ul>	<p><b>Traps for the Unwary:</b></p> <ul style="list-style-type: none"> <li>Must be sure that Bylaws of the subsidiary organization clearly define the member's powers and rights</li> </ul>	<p><b>Traps for the Unwary:</b></p> <ul style="list-style-type: none"> <li>Dealing with employee and benefit transition matters takes longer than anticipated and often is the issue that postpones the closing</li> <li>Third-party and governmental contracts often require consent before they can be assigned from the entity going away to the surviving entity of the merger</li> </ul>

## Meet the Authors



**Erin Whitney Cicchetti**  
Partner, Tax Department



**Melissa Sampson McMorrow**  
Chair, Tax Department

## Proposed Regulations on Donor Advised Funds: Summary and Insights

Many donors have come to rely on donor advised funds as a tool for carrying out their charitable goals. Donor advised funds, or DAFs, have grown significantly in popularity over the years, but Congress and the Internal Revenue Service have found them challenging from a regulatory standpoint. A DAF generally can be described as a fund within a public charity (a so-called sponsoring organization) over which a donor (or other designees) has advisory privileges as to how distributions are made from the fund. They often can function in a manner similar to a private foundation without creating a separate charitable entity and without the administrative burden of a private foundation. When funding a DAF, a donor makes an irrevocable donation to the fund and receives an income tax deduction. The sponsoring organization is required to inform the donor of the fact that the donated assets are within the exclusive control of the sponsoring organization, even though certain advisory privileges are granted.

The concept of a DAF was not contained in the Internal Revenue Code until 2006, when legislation was enacted as part of the Pension Protection Act of 2006 to codify the rules of operating for DAFs. That legislation left significant gaps in guidance that were intended to be filled by regulations. After a 17 year wait, proposed regulations were issued by the Department of Treasury in November 2023. A brief summary of those proposed regulations is contained below. At a hearing held on the proposed regulations in February 2024, many concerns were raised regarding key provisions of the proposed regulations. One of the key concerns is that the proposed regulations, once finalized, could have a retroactive effective date. Although it is quite possible that changes will be made in the final regulations to address some of the concerns raised by practitioners and members of the industry, we want to share an outline of the current state of the proposed regulations given the importance of DAFs for organizations that sponsor them and for donors who rely on them in carrying out their charitable objectives.

### Donor Advised Fund (DAF) Definition

A DAF is a fund or account:

- that is **separately identified** by reference to contributions of a donor or donors;
- that is **owned and controlled by a sponsoring organization**; AND
- with respect to which **at least one donor or donor-advisor has, or reasonably expects to have, advisory privileges** with respect to the **distribution or investment of amounts held in such fund or account** that meets all three prongs of the definition.

DAFs created by most public charities and governmental bodies would not be subject to these rules, but DAFs created by private foundations and certain so-called supporting organizations would be subject to them as well.

### Distribution Definition

One of the concerns of the proposed regulations is that the definition of “distribution” is too broad. The proposed regulations describe a distribution as any grant, payment, disbursement, or transfer, whether in cash or kind, from a DAF. Investments and reasonable investment or grant-related fees are not considered distributions under the proposed regulations; provided, however, that a distribution includes an expense charged solely to a particular DAF that is paid, directly or indirectly, to a donor, donor-advisor, or related person with respect to the DAF. A distribution also includes any use of DAF assets that results in a more than incidental benefit to a donor, donor-advisor, or related person. This proposed inclusion of payments to donors, donor-advisors, or other related parties is concerning particularly also in providing with DAFs in which a person's personal investment advisor also is providing investment advice on the assets held within the DAF (more on this issue, below) because impermissible distributions give rise to punitive excise taxes and other negative consequences to both the advisor involved and the sponsoring organization.

### Donor-Advisor Definition

Another concern with the proposed regulations is that the proposed definition of “donor-advisor” is too broad, particularly with respect to personal investment advisors. Under the proposed regulations, a donor-advisor is a person appointed or designated by a donor to have advisory privileges regarding the distribution OR investment of assets held in a fund or account of a sponsoring organization. An investment advisor who manages the investment of, or provides investment advice with respect to, both the assets maintained in a DAF and the personal assets of a DAF is deemed to be a donor-advisor while serving the dual role unless the investment advisor provides advice to the sponsoring organization overall. If these regulations are finalized as proposed, it would significantly restrict the ability of a donor's personal investment advisor to be involved in advising on the funds of a DAF.

### Effect on Advisory Boards and Fiscal Sponsor Relationships

The final concern regarding these proposed regulations that we will highlight is the potential effect of the proposed donor-advisor definition on the functioning of advisory boards or committees, including fiscal sponsorship arrangements. Members of advisory bodies and principals of organizations that are being incubated by charities under fiscal sponsorship arrangements generally have not been concerned about the DAF law. Under these proposed regulations, their manner of operations may be adversely impacted.

### Funds Not Considered DAFs

Exceptions to these rules (i.e., carve outs) apply for funds that support a single, identified organization, for funds that maintain certain scholarship programs, and for disaster relief funds. If a fund meets one of these exceptions, these proposed rules, and the negative consequences of violating them, do not apply. The details of which are beyond the scope of this summary, but could be useful for some funds if the proposed regulations are finalized.

### Conclusion

Donor advised funds have had a significant impact on the distribution of philanthropic funds. They provide an effective and efficient means of managing charitable causes. While well formulated laws and regulations can help to improve the impact of DAFs on the charitable sector, it is not clear that these proposed regulations do that. We are monitoring the developments in this area and will continue to provide updates and our insights as developments occur.

## CURTIS STRATEGY | Contributing Author

Curtis Strategy is dedicated to empowering organizations to navigate complexity and achieve sustainable growth. With a commitment to excellence and a deep understanding of industry dynamics, Curtis Strategy partners with clients to deliver tailored strategies that drive measurable results.

The approach at Curtis Strategy is rooted in collaboration, integrity, and innovation. The team works closely with clients to uncover opportunities, mitigate risks, and capitalize on market trends. By combining rigorous analysis with creative problem-solving, Curtis Strategy helps businesses thrive in a rapidly changing world.

## Charting the Course: A Practical Guide to Nonprofit Succession Planning

A leadership crisis looms over the nonprofit sector, with nearly 70% of CEOs nearing retirement within five years. To ensure continuity of vital services, organizations must urgently prioritize succession planning. However, many nonprofits struggle to tackle the challenge of succession due to internal barriers like fear of change, lack of bench strength, competing priorities, and perceived limitations in time and resources. These obstacles can hinder their ability to proactively prepare for leadership changes and secure the long-term stability of their missions.

Fortunately, a clear and consistent succession planning process can break down these barriers and empower nonprofits to navigate leadership transitions with confidence. This article will explore the common challenges organizations face during succession planning and how a well-structured process can effectively address them.

### Common succession planning obstacles:

- Resistance to change. Organizations, like individuals, can be resistant to change.
- Lack of alignment priorities and focus. Differing priorities, perspectives, and goals between the Board and senior leadership can not only slow down the process, but lead to identifying the wrong successor.
- Lack of clearly defined roles. When multiple stakeholders perceive ownership of the process without clearly defined roles, it can lead to confusion, duplication of effort, conflicting priorities, and ultimately, the initiative being deprioritized amidst day-to-day demands.
- Inadequate Talent Pool: Organizations may struggle to identify and develop a strong bench of internal candidates with the necessary skills and competencies to assume leadership roles.
- Inadequate Metrics: Accountability extends to results, meaning that succession plans, like strategic plans, must include measurable outcomes and metrics.

While each of these challenges poses a significant hurdle on its own, their combined effect can be overwhelming. A well-defined planning process can overcome these challenges, giving you the confidence and tools needed to create a seamless leadership transition. Our step-by-step guide to develop an effective succession plan will ensure a smooth transition while preserving your organization's mission.

**1. Initiate the Discussion:** Regardless of a CEO's retirement timeline, proactively initiating a robust succession planning process discussion with the Board of Directors is a crucial responsibility of their leadership. This involves making a strong case for succession planning and addressing any concerns, ultimately demonstrating the CEO's commitment to the organization's long-term success.

**2. Define Leadership Criteria:** While the CEO plays a crucial role in initiating succession planning, it is the Board of Directors, Executive Committee, or Succession Committee that should lead the process of defining the leadership criteria and competencies required for the CEO role. Effective leaders set a strategic vision, align resources, inspire action, and own results, all while embodying the organization's core values. Candidates should also be evaluated with the organization's long-term vision in mind. Needs evolve, and today's ideal fit may not be the right choice in ten years.

**3. Establish Clear Ownership and Responsibilities:** In CEO succession, the board plays a pivotal role in driving the process, establishing a clear framework with well-defined opportunities for input from the CEO. This collaborative approach ensures alignment between the board's vision and the CEO's insights. Additionally, the board should actively cultivate relationships with senior leadership to identify and mentor high-potential individuals, thus strengthening the organization's overall leadership pipeline. While the board focuses on CEO succession, the CEO retains responsibility for developing succession plans for the rest of the senior leadership team.

**4. Identify and Assess Potential Successors:** Once the leadership framework is established, the organization should identify a diverse pool of potential successors, internal or external, who meet the defined criteria. A comprehensive assessment of their capabilities is crucial, utilizing methods such as 360° reviews, interviews, performance reviews, leadership assessments, strategic planning and vision exercises. This multifaceted approach ensures a thorough understanding of each candidate's strengths, weaknesses, and potential to lead the organization successfully.

**5. Develop and Implement Development Plans:** For internal candidates, create individualized development plans to address skill gaps and enhance leadership potential through mentorship, coaching, and targeted assignments. Additionally, establishing a realistic timeline for the process and their ability to achieve these developmental goals allows both the candidate and the organization to assess progress and readiness. If an external successor is needed, define a transparent and equitable process to ensure a fair selection and maintain the integrity of the succession planning initiative.

**6. Communicate Transparently:** Transparency and open communication are paramount throughout the succession planning process. This involves managing expectations of both internal and external candidates, providing constructive feedback to those who are not selected, and addressing potential anxiety among employees regarding leadership changes. By fostering a culture of open dialogue and providing clear explanations, the organization can ensure a smooth and seamless transition, minimizing disruption and maintaining employee morale.

**7. Execute the Transition:** When the time comes for the CEO to step down, the organization should execute the transition plan, ensuring a seamless handover of responsibilities and minimizing disruption to the business. This may involve a period of overlap, where the outgoing and incoming CEOs work together to ensure a smooth transfer of knowledge and relationships. The new CEO should focus on building relationships with the Board, especially the Chair, building relationships with the team, and setting their strategic vision for the organization.

Once your plan for CEO succession is in place, don't forget to regularly review and update it. Remember that you may need to account for shifting sector needs and changes in the economic landscape, successful development and retention of potential internal candidates, and changes in the strategic direction of the organization.

It is also important to note that succession planning is not limited to the CEO position; it is a critical process that should encompass every key role within the organization, from the Board of Directors to senior leadership and even key individual contributors at all levels. By developing an active and comprehensive succession strategy for each critical position, the organization ensures continuity, minimizes disruption, and safeguards its long-term success in the face of any kind of transition.

For additional insights and best practices in succession planning, consult [Curtis Strategy's Succession Best Practices Guide](#).



**Contributing Author**  
**Nell Callen, Partner**



## About Nutter's Nonprofit Practice Group

Nutter's Nonprofit Practice Group provides a wide range of services to nonprofit organizations, individuals, and businesses utilizing an interdisciplinary team approach that focuses on each client's specific needs. We counsel healthcare, educational, human services, religious, and cultural institutions, as well as donor advised funds, corporate and family foundations, and generations of philanthropic families. Our reach expands beyond charitable organizations to include trade associations, chambers of commerce, social welfare organizations, social clubs, and for-profit enterprises intent on developing or enhancing their philanthropic strategies.

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Our mailing address is:  
155 Seaport Blvd., Boston MA 02210 United States



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