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Office of Thrift Supervision
Department of the Treasury

Harris Weinstein
Chief Counsel

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6404

November 12, 1992

[redacted]

RE: Creation of Private Foundation for Charitable Contributions

Dear Mr. Maher:

This responds to your letter of July 8, 1992 to Ms. Kathleen McNulty at the West Regional Office of the Office of Thrift Supervision ("OTS"), as supplemented on October 16, 1992, inquiring whether [redacted], [redacted] (the "Association"), may establish a tax-exempt private foundation within the meaning of sections 501(c)(3) and 509(a) of the Internal Revenue Code to manage and distribute the charitable contributions of the Association and its affiliates. Your letter was referred to the Chief Counsel's office for reply.

For the reasons set forth below, we conclude that the Association does have legal authority to establish a charitable foundation of the type described below pursuant to the "incidental powers doctrine." However, all contributions to the foundation must satisfy the OTS's current guidelines for charitable contributions, which are described below.

I. Background

The Association and its corporate affiliates currently make charitable contributions to broad-based community groups that provide affordable housing, mentoring for youth, teacher recognition, scholarships for minorities, citizenship training, health services, and support for the arts. All organizations receiving contributions are exempt from federal income tax pursuant to section 501(c)(3) of the Internal Revenue Code.

The Association believes that creation of a tax-exempt charitable foundation would enable it to coordinate charitable giving by the Association and its corporate affiliates more effectively, for several reasons. First, the foundation would help the Association and its affiliates establish a more consistent level of charitable giving. Presently, the amount of contributions made by the Association and its affiliates fluctuates from year to year based on profitability. A foundation would be able to level out this giving pattern by setting aside some of the funds received in profitable years for use in lean years. A more consistent giving pattern is expected to generate a higher level of community goodwill toward the Association and its affiliates and would avoid disruption of the income stream of charities that the Association has made a commitment to supporting. Second, the foundation would centralize responsibility for administration and allocation of corporate charitable funds. This would enable the Association and its affiliates to increase the effectiveness of their charitable giving program by achieving economies of scale, eliminating overlap, developing greater expertise in assessing grant applications, and following a unified charitable giving strategy. Third, the very act of establishing and maintaining a foundation is expected to enhance the Association's reputation for community service.

You represent that the Association will maintain control over the foundation either directly or by creating a self perpetuating board of directors of the foundation, a majority of which will consist of officers or directors of the Association. You also indicate that the instrument creating the foundation will provide that the foundation: (i) will permit such examinations as the OTS deems necessary and pay the cost of such examinations; (ii) will comply with any supervisory directives issued by the OTS regarding operations of the foundation; (iii) will provide annual reports to the OTS of amounts and recipients of all grants and distributions by the foundation, in such detail as the OTS may require; (iv) will operate under written policies approved by its board; and (v) will not engage in any self-dealing transactions as defined in the Internal Revenue Code and will comply with all laws necessary to maintain its tax-exempt status.

II. Discussion

The OTS and its predecessor agency, the Federal Home Loan Bank Board (the "FHLBB"), have long recognized that federal savings associations have "incidental" powers, i.e., powers that are incident to the express powers of federal savings

associations as set forth in the Home Owners' Loan Act.[1]

The seminal case defining the scope and limitations of the incidental powers doctrine as applied to federal financial institutions is Arnold Tours v. Camp, 472 F.2d 427 (1st Cir. 1972). There, the court ruled that an activity will be deemed to fall within the incidental powers doctrine if it is:

> convenient or useful in connection with the performance of one of the [institution's] established activities pursuant to its express powers under [statute]. If this connection between an incidental activity and an express power does not exist, the activity is not authorized as an incidental power.[2]

Although the Arnold Tours case concerned a national bank, the standard announced in that case has been applied subsequently by the courts and the federal banking agencies to all types of federal financial institutions, including federal credit unions,[3] the Federal Home Loan Banks,[4] and federal savings associations.[5]

It is well established that federal savings associations have authority, pursuant to the incidental powers doctrine, to make charitable contributions.[6] Because charitable contributions tend to promote name recognition and goodwill within the communities served by savings associations, charitable contributions have been viewed as a proper incident to the express statutory authority of savings associations to

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1. E.g. 57 Fed. Reg. 48942 (1992) (operating subsidiary regulation); and 49 Fed. Reg. 29357, 29358 1984) (finance subsidiary regulation).

2. Arnold Tours at 432.

3. See American Bankers Association v. Connell, 447 F.Supp. 296, 298 (D.D.C. 1978).

4. See Central Bank, N.A. v. Federal Home Loan Bank of San Francisco, 430 F.Supp. 1080, 1085 (N.D. Cal. 1977), and Association of Data Processing v. Federal Home Loan Bank Board, 568 F.2d 478 (6th Cir. 1977).

5. See 49 Fed. Reg. 29357, 29358 (1984) (finance subsidiary regulation).

6. See FHLBB Manual Op. B57, July 1, 1941; and FHLBB Op. by Smith, June 9, 1987.

advertise.[7]

Instead of making charitable contributions directly, however, the Association seeks authorization to channel its contributions through a foundation to be established and controlled by the Association. You acknowledge that an opinion of the former FHLBB concluded that federal savings associations do not have authority to establish foundations. You note, however, that the reasoning in this opinion was conclusory. You also note that the Office of the Comptroller of the Currency ("OCC") has affirmatively authorized national banks to establish charitable foundations pursuant to the incidental powers doctrine.[8] For these reasons, you argue that the OTS should reconsider the former FHLBB's opinion. We agree.

In our view, the Association's proposal to establish a private foundation meets the Arnold Tours test. First, as indicated above, past opinions of the FHLBB have accepted the proposition that charitable giving is a legitimate means of advertising, which, in turn, is expressly authorized by statute. Second, the Association has cited several plausible reasons why establishment of a charitable foundation will enable the Association to coordinate its charitable contributions more effectively. See Part I above. In other words, the Association has demonstrated that the foundation would be a "convenient and useful" way to conduct the charitable giving portion of its advertising program. Thus, there is a clear nexus between the Association's proposal to establish a foundation and the Association's express statutory authority to advertise. Accordingly, we conclude that the Association, acting pursuant to the incidental powers doctrine, may establish and operate a tax-exempt private foundation in the manner proposed.

When making contributions to this foundation, however, the Association must adhere to established OTS guidelines for charitable contributions. Acceptable charitable contributions generally should promote better public relations that further the Association's objectives and purposes, be reasonable in duration and amount so as not to strain the Association's resources, and be likely to produce beneficial advertising for the Association.[9]

The OTS does not require federal savings associations to give prior notice or receive prior approval before making charitable contributions. Nevertheless, contributions are

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7. 12 U.S.C.A. § 1468a (West Supp. 1992).

8. 50 Fed. Reg. 19324 (1985).

9. See FHLBB Op. by Smith, June 9, 1987; and OTS Op. Chief Counsel, December 26, 1991.

subject to supervisory review through the examination process.[10] Furthermore, it is the fiduciary duty of the directors to ensure that contributions are made in the best interests of the association.

Finally, as a general rule funds contributed to the foundation should not exceed the deductible limitations set forth in the Internal Revenue Code. If the Association's contributions exceed the deductible limit, its board of directors must justify the amount in the minutes of its meetings.[11]

In reaching the foregoing conclusions, we have relied upon the factual representations contained in your July 8, 1992 letter, as supplemented on October 16, 1992. Our conclusions depend on the accuracy and completeness of those representations. Any material change in circumstances from those you have described could result in conclusions that differ from those expressed herein.

If you have any further questions, please feel free to contact John Flannery, Attorney, at (202) 906-7293.

Very truly yours,

Harris Weinstein
Chief Counsel

cc: Regional Director
Regional Counsel
West Region

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10. Id.

11. A similar requirement is imposed by the OCC. See 50 Fed. Reg. 19324 (1985).