Charitable Planning for Disaster Relief

I. INTRODUCTION

The purpose of this guide is to provide an overview of options and best practices for attorneys assisting donors and charitable organizations hoping to provide disaster relief to survivors after a traumatic event. The guide also provides references to a variety of detailed sources available to consult throughout the life-cycle of a disaster relief organization.

II. OPTIONS FOR PROVIDING DISASTER RELIEF

In the face of a disaster, practitioners have the option to work with an existing entity (or entities) or form a new charitable organization. It is often desirable, if possible, for disaster relief to be provided through 501(c)(3) charitable organizations. Potential donors and partners may have greater trust in 501(c)(3) charities than in non-charitable providers of disaster relief assistance. Working with 501(c)(3) charitable organizations also provides a number of tax advantages: (i) the organization is exempt from federal income tax and thus can use more of its resources towards its charitable purposes; (ii) donations to the organization are income tax-deductible to the extent permitted by law; (iii) other 501(c)(3) charitable organizations, particularly private foundations, are more easily able to support the organization, and (iv) donations to the organization are not subject to gift tax.

Often it is not necessary to create a new 501(c)(3) organization in order to provide assistance and relief for survivors following a major disaster. The creation of a new entity is generally the most complicated and time-consuming option and other avenues should be considered to see if the client's relief goals can be accomplished in a simpler and more expedited manner.

A. **Use of an existing charity**.

If there is an existing 501(c)(3) public charity whose mission matches the client's goals, then having funds or other forms of relief flow through this entity will often be the best solution. Large existing charitable organizations having established community assistance programs can be an effective means of providing immediate relief. Additionally, the existing charity may be able to provide access to additional resources, and it may have valuable experience that can be leveraged to support the relief efforts. As discussed in IRS Publication 3833,[1] creating a new entity and applying for tax-exempt status can be time-consuming and waste precious time and resources. Working with existing charitable organizations can be a more efficient way of administering immediate relief as well as continuing to offer assistance over the long term.

Options and factors to consider when working with an existing 501(c)(3) charitable organization include the following:

- **Existing charities not organized to provide disaster relief** – If a 501(c)(3) charity was not organized specifically to provide disaster relief and if such disaster relief activities were not specified on the charity's application for

[1] I.R.S. Publ'n 3833 (Rev. Dec. 2014), https://www.irs.gov/pub/irs-pdf/p3833.pdf.

501(c)(3) status, the charity *can* still engage in disaster relief activities as long as they are consistent with the charity's mission and the requirements applicable to 501(c)(3) organizations.[2] The charity seeking to engage in disaster relief need not obtain authorization from the IRS beforehand; however, the charity needs to report the new activities on its annual tax filing, and it may report the change to the IRS Exempt Organizations Determinations Office.[3] An existing charity engaging in disaster relief activities must also satisfy the requirements discussed in more detail below: the disaster relief efforts must (1) benefit a charitable class and (2) the organization must make a determination that the persons receiving assistance are in need.

  - Note, however, that some donors may have concerns about whether existing charitable organizations, particularly large organizations with widespread programs, will actually use the donor's funds for the specific relief effort that prompted the donor to give.

- **Donor Advised Funds** – Persons holding advisory privileges with respect to donor-advised funds may recommend grants to existing 501(c)(3) public charities to assist with disaster relief efforts. Some donor-advised fund sponsoring organizations provide a vetted list of charities supporting disaster relief efforts which donors can access and consider when making recommendations for distributions.[4] However, donor-advised funds cannot make grants to new charities that have not received a determination of 501(c)(3) status from the IRS, even if they are in the process of applying for 501(c)(3) status. This limits a donor-advised fund's ability to support new charities waiting to receive tax-exempt status created in the wake of disaster. Given the increasing number of donors who make charitable contributions through donor-advised funds, this could be a significant issue for new charities wishing to move quickly in the wake of a disaster and is another reason to consider working through an existing 501(c)(3) public charity to provide disaster relief.

- **Community Foundations** – Working with community foundations in particular may be a strategic and efficient method for engaging in disaster relief activities. A community foundation is typically a public charity that manages funds and distributes the income (or in some cases, principal) for the benefit of the community. Community foundations usually are managed by a governing body made up of representatives from the community—most often a combination of

[2] Additionally, a qualified charitable organization also can give money to another qualified charity to carry out disaster relief. *See Disaster Relief Charitable Organizations May Donate to Other Qualified Charities*, I.R.S., https://www.irs.gov/charities-non-profits/charitable-organizations/disaster-relief-charitable-organizations-may-donate-to-other-qualified-charities.

[3] I.R.S. Publ'n 3833 (Rev. Dec. 2014), https://www.irs.gov/pub/irs-pdf/p3833.pdf.

[4] *See e.g. COVID-19: How to Give in a Time of Great Need*, Vanguard Charitable Endowment Program, https://www.vanguardcharitable.org/DAF-disaster-relief; *Disaster Relief*, Fid. Invs. Charitable Gift Fund, https://www.fidelitycharitable.org/guidance/disaster-relief.html. The IRS also provides a database of tax exempt organizations. *See Tax Exempt Organization Search*, I.R.S., https://www.irs.gov/charities-non-profits/tax-exempt-organization-search.

private citizens and government officials. The foundations often serve as central vehicles to hold funds before the funds are granted to other vetted, local non-profits in the community. Community foundations also often serve as sponsoring organizations of donor-advised funds and work with both donors and advisors of donor-advised funds to facilitate and recommend community-focused grant-making. Community foundations can use their expertise to provide support following a disaster by helping local organizations and government leaders with immediate, short-term, and long-term needs.[5]

From the donor's perspective, donations to community foundations can provide the donor with flexibility and tax benefits together with assurance that the organization will continue to serve the community on a long-term basis. The donor may tailor the gift within the bounds of applicable tax rules.[6] The donor can leverage the organized effort and knowledge of the community foundation's governing body, staff, and advisors to maximize the impact of the gift. The donor may also request that the gift benefit a specific community organization or community project. Where a donor has general charitable interest, the community foundation can provide expert advice enabling the donor to direct the gift in a manner that meets the donor's philanthropic goals, such as a field-of-interest fund. The donor can also make an unrestricted contribution, which allows the governing body of the community foundation complete discretion with regard to distribution. The community foundation may pool together a donation with other funds to align with the donor's charitable intent when the donor's gift by itself would have been too small to have the desired impact. Because community foundations typically qualify as public charities for federal tax purposes, donations qualify for the more favorable tax treatment discussed below under "Private Foundation or Public Charity."

A number of community foundations have successfully and efficiently engaged in disaster relief activities. A few examples are:

- Essex County Community Foundation ("ECCF") & The Greater Lawrence Disaster Relief Fund:[7] In September 2018, three Massachusetts communities experienced gas explosions, which resulted in over 60 homes

[5] *Disaster Philanthropy*, Council on Foundations., https://www.cof.org/topic/disaster-grantmaking. In the face of immediate need, community foundations can mobilize volunteer groups, nonprofits, and the government to provide food, water, and shelter to survivors. In the short term, philanthropic investments can provide continued health and social services for survivors and dependents. In the long term, funding can play a key role in rebuilding communities, including physical restoration of infrastructure and the natural environment as well as assisting with economic and social rehabilitation.

[6] Donations to a community foundation cannot be "materially restricted" by the donor. Treas. Reg. § 1.170A-9(f)(11)(ii) (stating that a trust or fund may not be subject to material restrictions or conditions within meaning of Treas. Reg. § 1.507-2(a)(7)); *see* George Johnson & David Jones, *Community Foundations*, *in* Exempt Orgs. CPE. Tech. Instruction Program for Fiscal Year 1994, https://www.irs.gov/pub/irs-tege/eotopick94.pdf. (a material restriction imposed by the donor could impact the organization's ability to qualify for 501(c)(3) status).

[7] The full impact report detailing the Greater Lawrence Disaster Relief Fund's efforts to provide disaster relief is available at https://cdn.flipsnack.com/widget/v2/widget.html?hash=fxma7qljd.

being leveled or damaged, multiple injuries, and one death. Within the first days following the disaster, public officials of the three communities and the Massachusetts Governor established the Greater Lawrence Disaster Relief Fund at ECCF, which became the hub of fundraising efforts for providing relief to victims of the explosions. Just over two weeks after the disaster, ECCF opened an online application to allow individuals and businesses to easily apply for financial aid. The first round of stipends was paid out from the Fund by November 5, 2018. By December 2018, over $12 million had been distributed from the Fund in the form of stipend checks or vital wraparound services. Combining the efforts of volunteers and local non-profits, the Fund awarded more than 17,000 individual stipend gifts in total.

- Greater Houston Community Foundation ("GHCF") & the Hurricane Harvey Relief Fund:[8] In 2017, Hurricane Harvey hit the shores of the Gulf Coast, Houston and surrounding areas, causing over $125 billion in damages. The mayor of Houston, a county judge, and GHCF partnered to create the Hurricane Harvey Relief Fund, to be administered by GHCF. More than 127,000 donors responded to the call for help by donating over $114 million. The Fund dispensed aid in four focused rounds of funding between 2017 and 2019: (1) providing for basic needs and immediate relief; (2) assisting community organizations; (3) constructing case management and assistance systems; (4) engaging in efforts to rebuild homes and provide legal and behavioral health services. GHCF established connections and relationships among local governments and various nonprofits by convening groups that included traditional nonprofit service providers, community school districts, hospital systems, and grassroots organizations.

Community foundations are often the coordinators of local disaster relief philanthropy, providing an awareness of existing nonprofits and organizations firmly rooted in the community as well as an effective means for quick mobilization should disaster strike. When advising a community foundation, legal professionals should encourage community foundations to consider the following recommendations:[9] (1) maintain a standing structure (such as advisory boards or grants committees) to ensure quick activation in the event of disaster; (2) use data as well as feedback from the community to make informed grantmaking decisions; (3) conduct assessments of nonprofits to identify key partners and capacity gaps; (4) institute a grant-funding category to support

[8] An official memorandum from the Advisory Board of the Hurricane Harvey Relief Fund providing further background information, an impact report, and a formal, independent, third-party evaluation is available at https://ghcf.org/wp-content/uploads/2018/08/Hurricane-Harvey-Relief-Fund-Evaluation-Findings-v3.pdf. The third-party evaluation discusses considerations for future similar disaster relief funds such as maintaining a standard structure (e.g., an advisory board), leveraging the local community foundation's expertise and capacity, and establishing a disaster administration fund to increase "startup" expediency when disaster occurs.

[9] *See* Nikhil Bumb et al., *How Community Foundations Can Better Coordinate Responses to Disasters*, FSG, (Nov. 2018) https://www.fsg.org/blog/how-community-foundations-can-better-coordinate-responses-disasters.

investments in small or under-resourced organizations; (5) maintain operational flexibility and transparency; (6) support relationship building between nonprofits during non-disaster times; and (7) communicate with the public regarding disaster relief progress, needs, and challenges.

- **Fiscal Sponsorships with Existing Tax-Exempt Entity** –A fiscal sponsorship is a contractual arrangement that can allow a person, group, or entity (the project) to attract and receive charitable funding without having to set up a new charity, obtain 501(c)(3) status, and separately comply with the ongoing filing and registration requirements that apply to 501(c)(3) organizations.[10] A fiscal sponsorship arrangement can also facilitate more immediate access to charitable funding for organizations in the process of applying for tax-exempt status without having to wait for IRS approval. In such an arrangement, the project will find an existing 501(c)(3) organization to act as fiscal sponsor to the project, and the sponsor will agree to accept tax-deductible donations on behalf of the project and pass funds on for use in connection with the project. The sponsor, however, must maintain discretion and control over donated funds. The sponsor typically also provides oversight and support in running the project (and typically charges a percentage of the funds raised as an administrative fee). The scope of the project must fit within the sponsor's charitable mission and the use of the funds must be consistent with 501(c)(3) requirements. [11]

  Fiscal sponsorship can be an excellent option in the disaster relief sphere because projects (which may be limited in duration) can launch quickly without a newly formed entity having to obtain its own 501(c)(3) status. Alternatively, fiscal sponsorship can allow a newly formed non-profit that is awaiting a determination of its 501(c)(3) status to attract funding for its desired operations and build relationships with donors. Because the fiscal sponsor is tax-exempt, the funds received by the fiscal sponsor will be tax-deductible to donors, and the funds can be used towards the newly-formed entity's project. To ensure the responsibilities for each group are clear, there should be a written agreement between the fiscal sponsor and the sponsored organization and the two entities should communicate regularly. The San Francisco Study Center has created a national directory of fiscal sponsors.[12]

[10] National Council of Nonprofits, *Fiscal Sponsorship for Nonprofits*, https://www.councilofnonprofits.org/tools-resources/fiscal-sponsorship-nonprofits.

[11] For more detail on the requirements and options for fiscal sponsorships, *see Gregory L. Colvin and Stephanie L. Petit, Fiscal Sponsorship: Six Ways to Do It Right* (3d ed. 2019). *See also* I.R.S. Publ'n 4220 (Rev. Mar. 2018), https://www.irs.gov/pub/irs-pdf/p4220.pdf (discussing how a group or organization may obtain many of the benefits of 501(c)(3) status by affiliating with an existing charity that acts as its agent).

[12] San Francisco Study Center, *Fiscal Sponsor Directory*, https://fiscalsponsordirectory.org/.

B. Private (non-charitable) gifts. If a donor is not concerned with receiving an income tax deduction for his or her gift and/or has specific individual survivors he or she would like to benefit, then a private gift might be the best option to provide immediate assistance. Standard gift tax considerations apply to any private gifts.[13]

C. Availability of government assistance. Following a large-scale disaster, federal and local governments often provide immediate assistance to those affected, in the form of necessities, shelter and, sometimes, grants or other funds. Health and/or other benefits may be available through government programs in the longer term.

D. Employer-created fund to benefit employees impacted by a disaster. It is possible for a company to create a private foundation to provide assistance to employees or others in need after a disaster, but it must be careful not to violate the detailed rules regarding self-dealing and private inurement. Alternatively, an employee assistance fund can be created that does not qualify as tax-exempt but can still benefit needy employees. However, the employer and employee will need to consider whether distributions from such a fund are taxed as income to the employee.

III. NEW CHARITY: BASIC OVERVIEW

If other options have been considered and fail to achieve the client's goals, it is possible to establish a new organization for purposes of providing relief to survivors of a disaster; however, the appropriate rules must be followed. The new organization must apply to the IRS on Form 1023 if it wishes to obtain 501(c)(3) status. Such status enables the organization to function exempt from federal income tax and means that contributions to the organization are eligible for the charitable income tax deduction.[14] The application must demonstrate that the organization meets all of the usual requirements for 501(c)(3) status.[15] Alternatively, certain organizations anticipating less than $50,000 per year in revenues may be able to apply for 501(c)(3) status on the shorter, simpler (and more quickly processed) Form 1023-EZ (see section titled "Expedited Approval" below) although they must still in substance meet all of the same requirements for 501(c)(3) status.

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[13] *See* I.R.C. § 2503(b) (regarding the annual exclusion from gift tax); I.R.C. § 2501 *et seq* (regarding taxable gifts).
[14] *See* 26 U.S.C. §§ 501(a), (c); I.R.C. § 170(a)(1). *See also* I.R.S. Publ'n 526 (Rev. Feb. 2022), https://www.irs.gov/pub/irs-pdf/p526.pdf (discussing organizations qualified to receive contributions, types of deductible contributions, amount deductible, record-keeping requirements, and reporting requirements); I.R.S. Publ'n 561, (Rev. Jan. 2022), https://www.irs.gov/pub/irs-pdf/p561.pdf (determining the value of property other than cash given to qualified organizations).
[15] *See Exemption Requirements – 501(c)(3) Organizations*, I.R.S., https://www.irs.gov/charities-non-profits/charitable-organizations/exemption-requirements-501c3-organizations; *see also Application for Recognition of Exemption*, I.R.S., https://www.irs.gov/charities-non-profits/application-for-recognition-of-exemption.

A. **General Requirements for 501(c)(3) Organizations**.

In order to qualify as a 501(c)(3) charitable organization, an organization must meet the following requirements:

- ***Exempt Purpose.*** The organization must have a tax-exempt purpose. See the following section IV.A, "Charitable Purpose," for a discussion of charitable purposes in the context of disaster relief.

- ***No Private Inurement.*** No part of the earnings of the organization may inure to the benefit of any private individual. In other words, no individual may receive unearned payments or other profits or benefits from the organization. Any payments or other benefits to an "insider," such as a director, officer, or substantial contributor, or a family member of one of these persons, must be carefully scrutinized to ensure that they do not violate this rule.

- ***Political Activities.*** Attempts to influence legislation (i.e., lobbying) may not constitute a substantial part of the organization's activities. In addition, the organization must not participate or intervene in political campaigns in any way, including the publication or distribution of statements.

B. **Private Foundation or Public Charity.**

Section 501(c)(3) organizations are divided into two broad categories: private foundations and public charities.[16] Private foundations are often largely private charitable endeavors, such as family or corporate foundations. Public charities typically have more public or governmental involvement, making them more responsive to the public interest. For a variety of reasons discussed below, it is usually preferable for an organization to qualify as a public charity; however, it is also more difficult.

- ***Private Foundations.*** Any organization that does not qualify as a public charity (see below) will be characterized as a private foundation.[17] Private foundations are subject to strict operating requirements that do not apply to public charities. They must pay an excise tax of 1.39 percent on their net investment income and must expend a prescribed minimum amount (generally five percent) of its net investment assets for charitable purposes each year.[18] Additionally, private foundations and certain of their top managers are subject to severe excise taxes on various prohibited acts. These include stringent self-dealing rules[19] which

[16] There is also a third, less common category known as private operating foundations. Private operating foundations are organizations that are private foundations but generally engage in direct charitable activities. They must meet certain detailed requirements. *See Private Operating Foundations*, I.R.S., https://www.irs.gov/charities-non-profits/private-foundations/private-operating-foundations.
[17] *See* I.R.C. § 509.
[18] *See* I.R.C. §§ 4940(a), 4942(e)(1).
[19] Public charities and their managers are also subject to excise taxes on "excess benefit transactions" with persons who are in a position to exercise substantial influence over the organization. *See* I.R.C. § 4958 and the regulations thereunder.

prohibit many transactions with related parties even if they are at fair market value terms[20] as well as penalty taxes on various types of payments including certain grants to individuals, investments that jeopardize the foundation's charitable purposes, and the ownership of certain levels of interests in business enterprises.[21]

Private foundation status is also less desirable than public charity status for purposes of attracting contributions. While both private foundations and public charities are exempt from federal income tax, donations to private foundations by individuals are subject to a lower deduction limit, calculated as a percentage of the donor's adjusted gross income.[22] In addition, some potential donors will not as a matter of policy make grants to private foundations.

- ***Public Charities.*** Because of these restrictions, if possible, it is generally preferable for an organization to qualify as a public charity. There are a number of ways in which an organization can qualify, although not every organization will be able to do so. Certain types of organizations, such as churches, schools, hospitals and medical research organizations, automatically qualify as public charities.[23] Other organizations may be able to qualify by meeting the "public support" test or by serving as a "supporting organization" to another public charity.

  - Public Charities: Public Support Test. In order to meet the public support test, an organization must show that it "normally" receives at least one-third of its support from qualifying public and/or governmental sources.[24] There are two different versions of the public support test. In both cases the test is determined by calculating a fraction, with the numerator being the amount received from qualifying public and/or governmental sources and the denominator being the total amount of support over the period in question. This fraction must equal at least one-third.

    Public Charities Supported by Donations**.** The first version of the public support test (the 170(b)(1)(A)(vi) test) generally applies to organizations that receive a substantial portion of their support from gifts, grants and other donations and/or membership fees.

    In this test, the denominator of the public support fraction – the total support – consists of gifts, grants and donations; membership fees; gross investment income (with the exception of capital gains); taxable income from unrelated business activities, less any

[20] *See* I.R.C. § 4941.
[21] *See* I.R.C. §§ 4943, 4944, 4945.
[22] *See* I.R.C. § 170.
[23] *See* I.R.C. §§ 509(a)(1), 170(b)(1)(A).
[24] *See* Treas. Reg. § 1.170A-9(f)(2).

taxes on that income; and all other revenues.[25] There are only a few exceptions: capital gains, gross receipts from the performance of the organization's charitable purposes (sometimes called exempt function income) and certain unusual grants.[26]

Eligible public support (the numerator of the fraction) consists of contributions and membership fees from individuals, trusts, corporations and/or other charities.[27] However, such contributions are subject to a special two-percent ceiling when calculating public support – they count as public support in the numerator of the fraction only to the extent that they do not exceed two percent of the organization's total support over the relevant period.[28] Thus, contributions to the organization from a single donor over the relevant period will count fully in both the numerator and the denominator only if the donor's contributions do not exceed two percent of the organization's total support over that period. If the donor's contributions do exceed two percent of the total support over that period, the contributions will count fully in the denominator but will only be included in the numerator to the extent of two percent of the organization's total support over the period.[29] In applying the two percent ceiling, all contributions made by a donor and certain related persons or entities are considered to be made by one person.[30]

An important exception to the two-percent rule provides that the ceiling does not apply to support received from government grants or other publicly supported charities.[31] Thus, a contribution from a governmental source or another publicly supported charity will count fully in both the numerator and denominator of the fraction. This rule does not apply to government contracts, which are considered to be exempt function income.

If the public support fraction is one-third or more, the organization automatically qualifies as a public charity. If the public support fraction is less than one-third but more than one-tenth, the charity may still qualify as a public charity if the IRS finds that it is organized and operated to attract public support under a facts and circumstances test.[32]

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[25] *See* Treas. Reg. § 1.170A-9(f)(7)(i); I.R.C. § 509(d).
[26] *See* Treas. Reg. § 1.170A-9(f)(6), (7).
[27] *See* Treas. Reg. § 1.509(a)-3(a)(2).
[28] *See* Treas. Reg. § 1.170A-9(f)(6).
[29] *See* Treas. Reg. § 1.170A-9(f)(6)(i).
[30] *Id.*
[31] *Id.*
[32] *See* Treas. Reg. § 1.170A-9(f)(3).

- Public Charities That Receive Exempt Function Income**.** The alternate version of the test (the 509(a)(2) test) generally applies to organizations that receive a significant portion of their support from exempt function income – that is, income they receive as a result of performing their charitable activities.

  The denominator of the public support fraction in this case includes the organization's exempt function income in addition to the amounts included in the denominator in the public support test described above. The numerator of the public support fraction includes donations and membership fees in their entirety, but it does not include any portion of donations or membership fees received from disqualified persons.[33] The numerator also includes exempt function income, but exempt function income from each source is only counted to the extent that it does not exceed the greater of $5,000 or one percent of the organization's total support during the taxable year. Exempt function income received from disqualified persons is excluded altogether.[34]

  In order to qualify under this test, the public support fraction must be at least one-third; there is no back-up facts and circumstances test as in the 170(b)(1)(A)(vi) public support test. Additionally, no more than one-third of the organization's total support can come from gross investment income (other than capital gains) and taxable income from unrelated business activities (less any taxes on that income).[35]

- Five-Year Average**.** In both versions of the public support test, the test is applied on an annual basis to five years' worth of operations.[36] The organization "normally" receives at least one-third of its support from qualified sources if it meets the public support test for the current tax year plus the previous four years of operation in the aggregate.[37] In other words, the test is applied on a five-year rolling average basis. Therefore, if the receipts from qualified sources are low in one year, the organization can make up for it if it receives excess donations from qualified sources in the following year. If the organization meets the public support test for five years of operation, it will be considered to satisfy the public support requirements for its current taxable year and the subsequent taxable year.[38] For example, an organization that

[33] *See* I.R.C. § 509(a)(2)(A).
[34] *Id.*
[35] *See* I.R.C. § 509(a)(2)(B).
[36] *See* Treas. Reg. § 1.170A-9(f)(4)(v)(A); T.D. 9423, 73 Fed. Reg. 52,528 (Sept. 9, 2008) (preamble).
[37] *See* Treas. Reg. § 1.170A-9(f)(4)(i).
[38] *Id.*

meets the public support test for the tax year 2020 based on the five-year period 2016-2020 will be considered a public charity for tax years 2020 and 2021.

- New Organizations. A new organization that does not have five years of history can request a ruling from the IRS that it is a public charity if it can reasonably be expected to qualify as a public charity under one of the two versions of the public support test. [39] The IRS will issue a determination letter stating that the organization is a public charity.[40] The organization will be a public charity for its first five years, regardless of the level of public support it actually receives.

  Beginning in the organization's sixth year, it will need to satisfy the public support test on an annual basis. If the organization does not satisfy the public support test for two years in a row, it will lose its public charity status and will be treated as a private foundation beginning at that time.[41]

Public Charities: Supporting Organizations. An organization which does not itself qualify as a publicly supported charity can still qualify for public charity status if it is organized and operated to support another public charity.[42] The governing documents of the supporting organization must state that its sole purpose is to support the supported organization, and the supporting organization must in fact operate to benefit, support or carry out the purposes of the supported organization.[43] The supporting organization cannot be controlled by disqualified persons.[44]

In addition, the supported organization must have a certain type of relationship with the supporting organization.[45] There are three types of relationships that can result in supporting organization status:

- Type I (Parent – Subsidiary): In this type of relationship, the supported public charity appoints a majority of the board of directors of the supporting organization.[46]

- Type II (Brother – Sister): Here, the supporting organization and the supported public charity are controlled and managed by the same persons.[47]

[39] *See* Treas. Reg. § 1.170A-9(f)(4)(v)(A).
[40] *See* T.D. 9423, 73 Fed. Reg. 52,528 (Sept. 9, 2008) (preamble).
[41] *See* Treas. Reg. § 1.170A-9(f)(4)(vii)(A).
[42] *See* I.R.C. § 509(a)(3).
[43] *See* I.R.C. § 509(a)(3)(A).
[44] *See* I.R.C. § 509(a)(3)(C).
[45] *See* Treas. Reg. § 1.509(a)-4(f)(1).
[46] *See* Treas. Reg. §1.509(a)-4(f)(2)(i), (4); I.R.C. § 509(a)(3)(B)(i).

- Type III ("Relationship Test"): The supporting organization can satisfy the "relationship test" by being responsive to the needs or demands of the supported public charity and being an integral part of the supported public charity.[48] This historically was the most flexible of the three types of relationship, but more recent legislation has imposed new requirements on Type III supporting organizations which make it more difficult for them to attract certain types of funding.

C. **Expedited Approval.**

IRS Publication 4220 presents general guidelines for organizations that seek exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code (the "Code").[49] Typically, applications for exemption are processed in the order in which they are received, and applicants may wait six months or more to receive a determination letter.

However, under certain circumstances a disaster relief or emergency hardship organization may apply for expedited processing of its application for exemption if it can show a compelling reason for doing so.[50] The organization must show "that it is meeting an immediate need of disaster relief or emergency hardship victims and that its ability to provide immediate assistance to such victims will be adversely impacted in a material way if the application is not reviewed expeditiously."[51] Merely indicating that the organization will provide disaster relief is generally not specific enough or sufficient for expedited approval.

IRS Publication 3833 and the instructions for completing Form 1023 list the information that should be included in an application for expedited processing, including a description of the specific disaster, an explanation of the immediate need for the services to be provided by the organization, and an explanation of any grants or other funding sources that are dependent on expedited processing.[52]

The IRS has indicated a request for expedited processing must:[53]

a. Be made in writing;

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[47] *See* Treas. Reg. § 1.509(a)-4(f)(2)(ii), (4); I.R.C. § 509(a)(3)(B)(ii).
[48] *See* Treas. Reg. § 1.509(a)-4(f)(2)(iii), (4); I.R.C. § 509(a)(3)(B)(iii).
[49] *See* I.R.S. Publ'n 4220 (Rev. Mar. 2018), https://www.irs.gov/pub/irs-pdf/p4220.pdf.
[50] Organizations can request expedited treatment by filing a letter or statement requesting expedited treatment along with its Form 1023. Applications should also be marked at the top with "Disaster Relief/Emergency Hardship Expedite." *See* RUTH RIVERA HUETTER & MARVIN FRIEDLANDER, DISASTER RELIEF AND EMERGENCY HARDSHIP PROGRAMS, 1999, https://www.irs.gov/pub/irs-tege/eotopick99.pdf; *see also* Rev. Proc. 98-4, 1998-1 I.R.B. 113, 135 at section 9.03(3).
[51] *See Applying for Exemption: Expediting Application Processing,* I.R.S., https://www.irs.gov/charities-non-profits/applying-for-exemption-expediting-application-processing.
[52] *See* I.R.S. Publ'n 3833, *supra* note 1.
[53] *See id*; *see also Applying for Exemption: Expediting Application Processing*, I.R.S., https://www.irs.gov/charities-non-profits/applying-for-exemption-expediting-application-processing.

b. Fully explain the compelling reason to process the application ahead of others;

c. Provide a brief description of the disaster and details of how the organization will provide relief;

d. Include an explanation of the immediate need for the specific disaster relief services the organization provides;

e. Include a description of any pending grants, including information about the grantor and the amount of property to be received;

f. Include an explanation of how the loss of the grants might impact the organization's ability to operate and provide relief;

g. Include a description of any significant business emergency (such as an impending deadline imposed by a court or government agency) demonstrating that the business emergency will significantly impact the applicant's ability to operate and explaining how expediting the application will enable the applicant to avoid the emergency;

h. Include a statement explaining any other anticipated consequences should the expedited processing be denied; and

i. Include the date an exemption letter is required, if applicable.

Alternatively, some non-profit organizations may be eligible to apply with the shorter version of the 501(c)(3) application, IRS Form 1023-EZ (*Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Code),* which may be submitted in accordance with Revenue Procedure 2019-5.[54] The EZ form applies to organizations with projected gross receipts of less than $50,000 per year for their first three years of operation and total assets of less than $250,000. An organization may not request expedited handling of a Form 1023-EZ, but typically the EZ form is processed much more quickly than the standard Form 1023.

IV. PROVIDING DISASTER RELIEF – SPECIFIC CONSIDERATIONS FOR EXISTING AND NEW CHARITIES

If you are considering creating a new charitable organization for the purpose of providing disaster assistance or if you are advising an existing charity that wishes to provide disaster assistance, IRS Publication 3833, "Disaster Relief: Providing Assistance Through Charitable Organizations," is a valuable resource and a useful starting point.[55]

The IRS updated this publication in the wake of September 11, 2001, and again in 2014. The publication sets forth the Internal Revenue Service's interpretation of the rules governing tax-

[54] Form 1023-EZ Eligibility Worksheet and Instructions are available online at *Instructions for Form 1023-EZ,* I.R.S., https://www.irs.gov/pub/irs-pdf/i1023ez.pdf.
[55] *See* I.R.S. Publ'n 3833 *supra* note 1.

exempt disaster relief organizations, and the IRS will apply these rules to applications for tax-exempt status filed by disaster relief organizations. The publication contains guidelines for providing aid to individuals following disasters and other emergencies, including a detailed analysis of the test the IRS believes organizations should apply to determine if an individual is a proper recipient of aid, discussed in more detail below (see section titled "Needs-Based (Needy or Distressed) Testing").

Publication 3833 also provides an overview and a reminder of the general rules for creating a public charity that qualifies for tax-exempt status under Section 501(c)(3) of the Code in addition to describing the processes an organization must follow if it wishes to provide assistance to disaster victims. The publication also provides guidance on record-keeping and reporting related to any assistance provided by a charitable organization in the wake of a disaster.

A. **Charitable Purpose.**

Section 501(c)(3) of the Code defines tax-exempt organizations as "corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition…. or for the prevention of cruelty to animals."[56] The IRS has determined that disaster relief qualifies as a charitable purpose.[57]

An organization must meet both an organizational test and an operational test to achieve 501(c)(3) status.[58]

Organizational Test. The organization's organizational documents, such as articles of incorporation or a trust agreement, must meet certain requirements to satisfy the organizational test. The organization may engage in any one or more of the enumerated activities under Section 501(c)(3); however, the organization's documents may not expressly allow the organization to engage in activities which are not in furtherance of one of the enumerated exempt purposes.[59] An existing charity can engage in new charitable activities by reporting those activities on its annual Form 990 or Form 990-EZ even if those specific charitable activities were not described in its 501(c)(3) application. If the organizational documents do not contain a broad charitable purposes clause that would cover the planned charitable activity, the organizational documents should be amended before engaging in the activity, and the organization should consider state law regarding donor intent before making use of previously donated funds for new purposes.

Operational Test. Under the Treasury Regulations, a charity may qualify for tax-exempt status if it is operated *primarily* for exempt purposes, as opposed to *exclusively* for exempt

[56] *See* I.R.C § 501(c)(3).
[57] *See* I.R.S. Publ'n 3833 *supra* note 1 (stating that organizations may provide aid to victims of disaster including both individuals and businesses); *see also* JANET GITTERMAN & MARVIN FRIEDLANDER, DISASTER RELIEF – CURRENT DEVELOPMENTS, 2003, https://www.irs.gov/pub/irs-tege/eotopicm03.pdf.
[58] *See* Treas. Reg.§ 1.501(c)(3)-1(a)(1).
[59] *See* Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(b) (clarifying that an organization *may* engage in non-exempt activities so long as they are an insubstantial part of the aggregate engagement).

purposes.[60] Under the operational test, a charity may engage in some activities not related to its exempt purposes and still maintain its tax-exempt status.[61] However, the organization must demonstrate that it is not organized or operated for the benefit of private interests.[62]

Additional relevant rulings and primary source guidance regarding the charitable purpose requirement include:

- In *Better Business Bureau of Washington D.C., Inc. v. United States*, 326 U.S. 279 (1945), the United States Supreme Court held that even one non-exempt purpose, if substantial in nature, can terminate an exemption no matter the number of legitimate exempt purposes.[63]

- In *Western Catholic Church v. Commissioner*, 73 T.C. 196 (1980), despite the petitioner's charitable activities offering counseling and distribution of a few grants to needy individuals, the Tax Court determined that the taxpayer failed to keep adequate records and that it was clear the petitioner received private benefit in his for-profit business. As a result, the Tax Court determined that the organization was not operated for purely exempt purposes.[64]

- Rev. Rul. 79-18 (January 1, 1979) provides that housing for the elderly may further a charitable purpose by relieving a distress to which the elderly may be susceptible regardless of financial condition.[65]Rev. Rul. 79-17 (January 1, 1979) provides that a hospice facility for terminally ill persons in need of specialized housing furthers a charitable purpose.[66]

- Rev. Rul. 78-99 (January 1, 1978) states that an organization providing counseling to widows during periods of grief and helping them overcome the legal, financial, and emotional problems caused by the death of a spouse qualifies as charitable by alleviating the widows' distress.[67]

- Rev. Rul. 71-99 (January 1, 1971) states that a not-for-profit entity organized to provide food and drink to first responders and other authorized personnel reporting for duty at the scene of major disasters serves a charitable purpose.[68]

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[60] *See* Treas. Reg. § 1.501(c)(3)-1(c)(1).
[61] *See* Treas. Reg. § 1.501(c)(3)-1(e)(2); I.R.C. §§ 511–515.
[62] *See* Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (describing private interests as those of "designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests").
[63] *See* Better Bus. Bureau of Washington, D.C., v. United States, 326 U.S. 279, 66 S. Ct. 112, 90 L. Ed. 67 (1945).
[64] *See* W. Cath. Church v. Comm'r of Internal Revenue, 73 T.C. 196 (1979), aff'd sub nom. W. Cath. Church v. Comm'r, 631 F.2d 736 (7th Cir. 1980).
[65] *See* Rev. Rul. 79-18, 1979-1 C.B. 194.
[66] *See* Rev. Rul. 79-17, 1979-1 C.B. 193.
[67] *See* Rev. Rul. 78-99, 1978-1 C.B. 152.
[68] *See* Rev. Rul. 71-99, 1971-1 C.B. 151.

- Rev. Rul. 69-174 (January 1, 1969) provides that an organization providing free emergency rescue services to stranded, injured or lost persons and to individuals suffering because of fire, flood, accident or other disaster is serving a charitable purpose.[69]

- In PLR 9547046 (August 31, 1995), the IRS found an organization formed to provide financial assistance to employees of a certain company and its subsidiaries who were "needy victims of natural disaster" met the charitable purpose test.[70]

B. **Charitable Class.**

Sufficiently large and definite. Disaster relief organizations, like other 501(c)(3) organizations, must provide benefits to a sufficiently large or indefinite[71] charitable class of beneficiaries.[72] If aid targets disaster victims in a certain geographic area, that area must be large enough that potential beneficiaries cannot be identified.[73] Aid may be provided to a smaller group of disaster victims as long as the potential group is indefinite, including those affected by a disaster now and in the future.[74] It can be difficult for disaster relief organizations to comply with the charitable class requirement, particularly for those explicitly organized to provide aid in the wake of a specific disaster. The organization cannot limit itself to a too-small group of beneficiaries, because if it does so it will fail to benefit the public as a whole.[75]

The IRS has stipulated that a pre-selected group of beneficiaries does not satisfy the charitable class requirement. In other words, donors may not earmark contributions to a charitable organization for a particular individual or family.[76] Organizations can help individuals who are part of a general class of charitable beneficiaries, if the organization ultimately makes the determination as to whom receives the assistance.

Charitable class cannot be separate from purpose. Even serving an ostensibly large class with many beneficiaries does not necessarily satisfy the charitable class requirement if a sufficient public element and an appropriate charitable purpose are lacking. An organization that established a grant-making program to benefit individuals who were impoverished and had significant financial needs as a result of, among other things, being victims of natural disaster, terrorism, acts of war and persecution *did* serve a sufficiently

[69] *See* Rev. Rul. 69-174, 1969-1 C.B. 149.
[70] *See* P.L.R. 9547046 (Aug. 31, 1995).
[71] The IRS interprets "indefinite" to mean that providing aid to members of the class benefits the community as a whole. *See* Gitterman & Friedlander, *supra* note 57.
[72] *See* I.R.S. Publ'n 3833, *supra* note 1.
[73] *Id.*
[74] *Id.*
[75] For extensive detail and history on the charitable class requirement, see Ellen P. Aprill, *Charitable Class, Disaster Relief, and First Responders*, 153 Tax Notes 949 (Dec.12, 2016).
[76] *See* I.R.S. Publ'n 3833, *supra* note 1; *see also* I.R.S. Publ'n 976 (Rev. Feb. 2018), https://www.irs.gov/pub/irs-pdf/p976.pdf.

large and indefinite charitable class because of the large size and open-ended nature of the eligible pool of grant recipients.[77]

Charity providing benefit to own members. A charitable organization may provide benefits to its members or to members of another charitable organization so long as the class of beneficiaries is *reasonably open-ended* and the beneficiaries are selected based on need.[78]

Remedying a narrow class. It may be possible to remedy a charitable class that is too narrow. If the organization is already in existence when the charitable class problem is identified, the group of potential beneficiaries should be expanded to include future victims. The organization's articles of incorporation may need to be amended using the procedure provided for under state law.[79]

High-profile disaster relief organizations have approached the issue of charitable class in various ways:

- The Oklahoma City Disaster Relief Fund established in the wake of the bombing of the federal building in Oklahoma City carefully complied with the IRS guidelines as to charitable class and financial needs testing. As a result, donated funds have been held by the organization for over two decades to provide for the "future needs of the victims."[80]

- Charitable organizations distributing funds to victims of the 9/11 terrorist attacks received special dispensation from the charitable class requirements in the form of the Victims of Terrorism Tax Relief Act (VTTRA). VTTRA specifically stated that payments made to those killed, injured or made ill as a result of the terrorist attacks on September 11, 2001, and anthrax attacks occurring in the months after the attacks furthered the charitable purpose of the organization.[81]

- The One Fund Boston identified the charitable class of beneficiaries as those affected by the Boston Marathon tragedy or any other attack which may occur in the United States in the future.[82] However, even with such language in the organizational documents, the IRS may still have concerns about the size of the charitable class based on the facts and circumstances of a particular charity.

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[77] *See* P.L.R. 200634016 (Aug. 25, 2006).
[78] *See* Gitterman & Friedlander, *supra* note 57.
[79] *See id.*. Rev. Proc. 84-47 cross-references Rev. Proc. 84-46, which lists the following as non-substantive amendments to organizational documents: "correction of a clerical error in the enabling instrument or the addition of a dissolution clause where the activities prior to the ruling or determination are consistent with requirements for exemption." Where a non-substantive edit is made to the articles of incorporation, the effective date of the organization's exemption letter will typically be recognized as the date of the organization's formation. *See* Rev. Proc. 84-46, 1984-1 C.B. 541; Rev. Proc. 84-47, 1984-1 C.B. 545.
[80] *See* Susan L. Abbott & Lisa A. H. McChesney, *Creating a Disaster Relief Charity: The One Fund Boston Model*, Taxation of Exempts (May/June 2014).
[81] *See* Victims of Terrorism Tax Relief Act of 2001, H.R. 2884, 107th Congress (2001).
[82] *See* Aprill, *supra* note 75.

Case law and IRS rulings provide examples and guidance regarding the charitable class requirement:

- *Geisinger Health Plan v. Comm'r.*, T.C. Memo 1991-649, held that the health care organization had a sufficiently broad class of possible members that it provided the requisite public benefit to qualify as tax-exempt under Section 501(c)(3) of the Code.[83]

- In *Wendy L. Parker Rehabilitation Foundation, Inc. v. Comm'r.*, T.C. Memo 1986-348, while the organization stated that it was created to benefit a charitable class, it was denied tax-exempt status because 30% of the funds were to be used to benefit one member of the class, the donors/founders were related to the recipient, and therefore the organization served primarily a private rather than public benefit.[84]

- *Charleston Chair Co. v. U.S.*, 203 F. Supp. 126 (E.D.S.C. 1962), held that an organization established to give scholarships to relatives of the organizer was not exempt, even if the students were financially needy.[85]

- In PLR 200621025 (May 26, 2006), the IRS denied an application for tax-exempt status by an organization that managed special needs trusts due to the lack of an indefinite charitable class of beneficiaries.[86]

- In PLR 201509039 (February 27, 2015), the IRS denied an application for tax-exempt status by an organization formed to aid small businesses in areas affected by disaster because it did not restrict its activities to a charitable class, the organization was operated for a commercial purpose based on pricing structure and competition with for-profit entities, and the organization did not restrict expenditures of funds to the accomplishment of the stated exempt purposes in its articles of incorporation.[87] The IRS denied exemption because, among other factors, small businesses in areas affected by a disaster are not a charitable class, per se.

- In PLR 9547046 (August 31, 1995), an organization was formed to provide financial assistance to employees of a certain company and its subsidiaries who were "needy victims of natural disaster" at any point in the future and had needs that were not otherwise covered by insurance.[88] The IRS pointed to the organization's large and indefinite pool of potential beneficiaries and its thorough screening processes and determined that the organization would not further a private interest and rather furthered a charitable purpose.

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[83] *See* Geisinger Health Plan v. Comm'r, 62 T.C.M. (CCH) 1656 (T.C. 1991), rev'd, 985 F.2d 1210 (3d Cir. 1993).
[84] *See* Wendy L. Parker Rehab. Found., Inc. v. Comm'r, 52 T.C.M. (CCH) 51 (T.C. 1986).
[85] *See* Charleston Chair Co. v. United States, 203 F. Supp. 126 (E.D.S.C. 1962).
[86] *See* P.L.R. 200621025 (May 26, 2006).
[87] *See* P.L.R. 201509039 (Feb. 27, 2015).
[88] *See* P.L.R. 9547046 (Aug. 31, 1995).

C. **Needs-Based ("Needy or Distressed") Testing.**

The regulations promulgated under Section 501(c)(3) of the Code state that the term "charitable" is used in the Code "in its generally accepted legal sense" and includes "relief of the poor and distressed or of the underprivileged."[89] Treas. Reg. §1.170A-4A(b)(2)(ii)(D) includes in the definition of "needy" a person who lacks the necessities of life as a result of temporary distress and includes disaster victims as an example.[90] Providing assistance to survivors of a disaster can therefore be a charitable purpose.

As reflected in IRS Publication 3833, however, the IRS believes that disaster victims are not automatically entitled to or eligible for all forms of charitable distributions simply by virtue of experiencing a disaster.[91] Charitable organizations that distribute funds directly to survivors to relieve the financial burdens they face generally must show that the distributions are made on the basis of the recipient's demonstrated need. While there is law and even language in Publication 3833 indicating that needs other than financial needs can be considered, the IRS has generally interpreted this to mean a demonstrated *financial* need. Individuals do not need to be completely destitute in order to receive assistance, but generally they must show that they lack the resources to obtain basic necessities.[92]

Therefore, a 501(c)(3) disaster relief organization must make an objective evaluation of the survivor's needs at the time that a grant is made.[93] Organizations which make distributions to individuals who are in need as the result of a disaster can qualify for exemption under Section 501(c)(3) of the Code; however, adequate case histories and records should be maintained.[94]

Different considerations apply based on the type of assistance offered:

- **Non-Financial Assistance:** The extent of needs-based testing required will typically evolve over the course of a disaster event. Charities providing non-monetary assistance such as rescue services, blankets or food in the immediate wake of a disaster serve a charitable purpose regardless of the financial situation of the recipients, so there is no need for a showing of financial need.[95] The further removed in time from the disaster event, the more individual financial needs-based testing will be required.

- **Financial Assistance:** According to IRS Publication 3833 and IRS continuing education materials, charities providing financial assistance should look at a potential recipient's available assets and anticipated cash flow as part of determining whether the individual is eligible to receive financial assistance.[96] Charities should keep in

[89] *See* Treas. Reg. § 1.501(c)(3)-1(d)(2); *see also* I.R.C § 170 (charitable deduction) for other descriptions of appropriate charitable beneficiaries.
[90] *See* Treas. Reg. § 1.170A-4A(b)(2)(ii)(D).
[91] *See* I.R.S. Publ'n 3833, *supra* note 1.
[92] *Id.*
[93] *See* Gitterman & Friedlander, *supra* note 57.
[94] *See* Rev. Rul. 56-304, 1956-2 C.B. 306.
[95] *See* I.R.S. Publ'n 3833, *supra* note 1.
[96] *See* Huetter & Friedlander, *supra* note 50.

mind that making a person whole after a disaster does not necessarily further a charitable purpose. "An outright transfer of funds based solely on an individual's involvement in a disaster or without regard to meeting the individual's particular distress or financial needs would result in private benefit."[97] Those who do not need continued assistance are not entitled to charitable resources.

Charitable organizations can make lump sum payments to survivors or they can purchase annuities to make future or periodic payments to survivors. For either form of assistance, the same needs-based testing and charitable class requirements apply (see Section titled "Charitable Class" above).[98]

A charity can also apportion funding between short-term and long-term relief efforts. Payments made out of funds set aside for long-term relief must be based on the needs of recipients as those needs exist at the time the payments are made.[99]

Charities can face pressure to quickly dispense funds to survivors of disaster and/or the families of victims who did not survive. Particularly for charities engaged primarily in immediate emergency relief efforts, if the charity has funds in excess of its needs, the charity might consider granting funds to other charities with the infrastructure to engage in long-term disaster relief based on an assessment of the needs.

Assistance to For-Profit Business. Publication 3833 outlines special tax considerations for certain types of recipients of disaster relief assistance. Charities are permitted to provide assistance to for-profit businesses affected by natural and civil disasters so long as providing such assistance is a reasonable means of accomplishing a charitable purpose.[100] Disaster relief payments to for-profit businesses will be examined under a facts and circumstances test to determine whether the business can exclude the payment from gross income as a gift under Section 102 of the Code.[101]

Record Keeping Practices. The organization must maintain records of its needs assessment procedures, including the process for selecting aid recipients, the objective criteria for disbursing aid, the needs and resources of each recipient, the types and amount of aid given to individuals and their identities, and the composition of the committee awarding aid.[102] Specifically, the organization should document: (i) a complete description of the assistance provided; (ii) the costs associated with that assistance; (iii) the purpose for which the assistance was given; (iv) the charity's objective criteria for disbursing assistance; (v) the methods used for selecting recipients; (vi) the name, address, and amount distributed for each recipient; (vii) the relationship, if

[97] *Id.*
[98] *See* Gitterman & Friedlander, *supra* note 57.
[99] *See* I.R.S. Publ'n 3833, *supra* note 1.
[100] *Id.*
[101] *Id.*
[102] *Id.*

any, between the recipient and members of or contributors to the charitable organization; and (viii) the composition of the selection committee approving the assistance.[103]

If the organization is engaging in short-term, non-financial disaster relief assistance (e.g., blankets, meals, etc.) then the organization should maintain documentation of (i) the assistance provided; (ii) the criteria for disbursing assistance; (iii) the date; (iv) the place; (v) the estimated number of victims assisted; (vi) the charitable purpose served; and (vii) the cost of assistance. As discussed above, the organization should keep more detailed records of long-term and financial aid.[104]

Additionally, public charities and private foundations generally must submit an annual tax return to the IRS on Form 990, Form 990-N, Form 990-EZ or Form 990-PF.[105] Information pertaining to grants may be required to be reported on the return.

To be prepared to effectively administer disaster relief, charities should consider developing and implementing substantive and technological infrastructure to support relief efforts. Charities engaging in disaster relief should also be aware that they may need to consider utilizing processes to obtain waivers from victims and survivors to permit the sharing of information for the limited purpose of providing disaster relief and to comply with legal requirements for protecting the individuals' private information, including but not limited to health information.

Additional relevant rulings and primary source guidance:

- In Rev. Rul. 55-406 (January 1, 1955), the IRS found that a nonprofit corporation which was formed for the purposes of receiving, investing and distributing funds to widows and children of policemen or fireman who lost their lives in the line of duty was tax-exempt.[106] The funds were distributed in the sole discretion of the board of directors. This is one of the few rulings approving the distribution of cash by a charity directly to individual victims.

- In Rev. Rul. 56-304 (February 1, 1956), the IRS set forth the record-keeping requirements when charitable organizations make distributions to individuals, such as keeping the name and address of recipients, amount distributed, purpose for aid, manner aid distributed, etc.[107]

- Rev. Rul. 79-18 (January 1, 1979) provides that housing for the elderly may further a charitable purpose by relieving a distress to which the elderly may be susceptible regardless of financial condition,[108] and Rev. Rul. 79-17 (January 1, 1979) provides

[103] *Id* ; see *also* Victoria B. Bjorklund & David Shevlin, *Responding Promptly to Needs for Disaster: Experienced Exempt Organizations Advisers Share Their Playbook*, American Law Institute (2013).
[104] *See* Gitterman & Friedlander, *supra* note 57.
[105] *See* I.R.S. Publ'n 3833, *supra* note 1.
[106] *See* Rev. Rul. 55-406, 1955-1 C.B. 73.
[107] *See* Rev. Rul. 56-304, 1956-2 C.B. 306.
[108] *See* Rev. Rul. 79-18, 1979-1 C.B. 194

that a hospice facility for terminally ill persons in need of specialized housing furthers a charitable purpose.[109]

- Rev. Rul. 78-99 (January 1, 1978) states that an organization providing counseling to widows during periods of grief and helping them overcome the legal, financial, and emotional problems caused by the death of a spouse qualifies as charitable by alleviating the widows' distress.[110]

- In PLR 9547046 (August 31, 1995), an organization provided financial assistance to employees of a certain company and its subsidiaries who were "needy victims of natural disaster" at any point in the future and had needs that were not otherwise covered by insurance.[111] The IRS pointed to the organization's large and indefinite pool of potential beneficiaries and its thorough screening processes when determining that the operations would not further a private interest and rather furthered a charitable purpose.

- In PLR 200634016 (August 25, 2006), a tax-exempt organization's grant-making program benefiting individuals who were financially needy due to being victims of natural disasters, violence, discrimination or terrorism was found to be in furtherance of the organization's charitable purposes.[112]

- In PLR 201509039 (February 27, 2015), the IRS denied an application for tax-exempt status by an organization formed to aid small businesses in areas affected by disaster because, among other reasons, small businesses in areas affected by a disaster are not a charitable class, per se, and because the organization did not restrict its charitable class to low income or otherwise needy areas.[113]

D. **Lessening the Burdens of Government.**

If a charitable organization seeking tax exempt status will not engage in financial means testing for recipients, the organization may instead be able to satisfy 501(c)(3) requirements under the "lessening burdens of government" standard. Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that an organization can be considered charitable if its purpose includes lessening the burdens of government.[114] The determination of whether an organization's activities lessen the burdens of government is based on a facts and circumstances test. Generally, this involves a review of (1) whether a governmental unit considers the activities to be its burden and (2) whether the activities of the charitable organization actually lessen that burden.[115]

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[109] *See* Rev. Rul. 79-17, 1979-1 C.B. 193.
[110] *See* Rev. Rul. 78-99, 1978-1 C.B. 152.
[111] *See* P.L.R. 9547046 (Aug. 31, 1995).
[112] *See* P.L.R. 200634016 (Aug. 25, 2006).
[113] *See* P.L.R. 201509039 (Feb. 27, 2015).
[114] *See* Treas. Reg. § 1.501(c)(3)-1(d)(2).
[115] An IRS Exempt Organization Continuing Professional Education publication available on the IRS website provides a detailed discussion of the test that is applied to determine whether or not an organization qualifies as tax-exempt under § 501(c)(3) as an organization that lessens the burdens of government. *See* ROBERT LOUTHIAN & AMY HENCHEY, LESSENING THE BURDENS OF GOVERNMENT, 1993, https://www.irs.gov/pub/irs-tege/eotopicb93.pdf.

1. Whether the government considers the activity to be part of its burden

To determine whether an activity is a burden of government, a key question is whether there is an "objective manifestation" by the government that it considers such activity to be part of its burden. Merely being engaged in activity that is sometimes undertaken by the government or having express approval of the government or an individual government official is insufficient. Letters or expressions from government officials praising a charitable organization's activities are not dispositive proof of the lessening of a government burden. Further, government approval of the activity is not a determining factor. Charitable organizations should be cautious in seeking tax exemption on this basis (or advising existing charities to proceed with disaster relief programs on this basis), as proving that the government considers the activity to be a part of its burden is a high threshold to meet.

There are various ways to prove that the government considers the activities to be its burden:

- **Statute creating or authorizing organization** – The clearest way to demonstrate objective manifestation is a statute that specifically creates the organization and clearly defines the organization's structure and purposes.[116] However, a statute may not always provide a clear path to exemption, if the statute cannot be construed as clearly intending activities to be performed by a limited class of non-profits.

- **Interrelationship with governmental unit –** Evidence of a favorable working relationship between the government and the charitable organization strongly corroborates that the organization is actually lessening the burdens of government.[117] Further, the more control the government has over the activities of the organization, the better the evidence of objective manifestation (e.g., the government appoints all of the directors of the organization).[118] However, it is important to distinguish between governmental officials participating in the organization in their official capacity and participation by officials acting outside of their official capacity. The presence of a public official on the board in a non-official capacity does not in and of itself indicate the existence of a governmental burden.[119]

- **Activity previously conducted by governmental unit –** Where a governmental unit engages in an activity on a regular basis for a significant length of time before the activity is taken over by a charitable organization, the activity *may* be a burden of

[116] *See* Louthian & Henchey, *supra* note 115 (providing the example of a corporation formed pursuant to statute that provides for the creation of industrial development corporations for enumerated public purposes where each has a governing body with substantial and direct government involvement manifesting that the activity is a burden of government (based on G.C.M. 39,852 (June 19, 1991))).
[117] *See* Rev. Rul. 85-2, 1985-1 C.B. 178.
[118] *See* Louthian & Henchey, *supra* note 115.
[119] *Id.*

government.[120] The government merely occasionally engaging in the activity, however, is not enough to demonstrate the existence of a governmental burden.[121]

- **Payment of governmental expenses –** The fact that the organization defrays general or specific expenses of local government or pays part of the government's debt is evidence of a governmental burden.[122]

- **Sources of funding –** If the organization regularly receives funding from the government in the form of general grants, as opposed to fees for services, that may indicate that the government considers the activity to be its burden.[123] For example, if the government funds the organization by issuing general obligation bonds, this could be evidence of a government burden. However, revenue bond financing does not demonstrate the existence of a government burden because it is available to private organizations.[124]

- **Whether the activity is one that could be performed directly by governmental unit (*analyze for all cases*) –** An important consideration in every case is whether the governmental unit could itself perform the activity engaged in by the organization.[125] State constitutions or statutes may prohibit municipalities from engaging in certain activities.[126] If the government cannot perform the activity, then it is unlikely the activity constitutes a burden of the government.

2. Whether the organization actually lessens the burdens of government

The determination of whether the charitable organization's activities lessen a burden of government requires an analysis of all relevant facts and circumstances.

- In Rev. Rul. 76-418 (January 1, 1976), the IRS ruled that providing free expert opinions to local government officials regarding hazardous traffic conditions actually lessened a governmental burden because it relieved the government of an activity it would otherwise have had to perform.[127]

- In PLR 9208002 (October 15, 1991), the IRS found that the operation of three motor vehicle registration facilities by an otherwise charitable organization was an activity unrelated to its charitable mission, because although operation of the facilities

[120] *Id.*
[121] *See* G.C.M. 39,347 (Mar. 15, 1985).
[122] *See* G.C.M. 39,733 (May 24, 1988).
[123] *See* Louthian & Henchey, *supra* note 115.
[124] *See* Rev. Rul. 85-2, 1985-1 C.B. 178.
[125] *See* Louthian & Henchey, *supra* note 115.
[126] *See* G.C.M. 38,693 (Apr. 15, 1981), involving a case where a state constitution prohibited a political subdivision from lending its credit to a private corporation. The organization's purposes included promoting economic activity, employment, and stability; however, the charitable organization did not reduce a burden of government where the government was statutorily and constitutionally prohibited from making the organization's intended expenditures.
[127] *See* Rev. Rul. 76-418, 1976-2 C.B. 145.

was a burden of government, the organization did not *actually* lessen the burden.[128] The relationship between the organization and the local government was more in the nature of a commercial contract for services than a lessening of the government's burden.

3. Whether the organization's activities serve a public purpose

Even if the organization's activities lessen a burden of government, the organization must still demonstrate that its activities serve a public rather than a private interest within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(1) (as discussed above).[129] The organization must demonstrate that any private benefit received by individuals or businesses is both qualitatively and quantitatively incidental to its exempt purposes. Any private benefit must be a necessary incidental result of activities which benefit the public at large and must be insubstantial in the context of the overall public benefit.[130]

If public interests outweigh the private interests served and the organization has satisfied the two-part test ((i) the burden is one of government and (ii) the organization actually lessens it), then exemption based on lessening the burdens of government is appropriate.

4. The One Fund Boston Example

The One Fund Boston was the first example of a charity that qualified as a 501(c)(3) organization in the disaster relief realm under the "lessening the burdens of government" standard.[131] Characteristics of the One Fund that enabled it to qualify as tax-exempt under the lessening the burdens of government standard include:

- The One Fund was created in the aftermath of the Boston Marathon bombings at the request of the Massachusetts Governor and the Mayor of Boston.

- The Articles of Incorporation stated that the One Fund was organized and operated for exclusively charitable purposes under Section 501(c)(3) of the Code.

- Its activities included lessening the burdens of government of the city of Boston regarding the Boston Marathon bombing, related events, and other attacks that might occur in the future.

- The Mayor of Boston appointed two-thirds of the One Fund's Board of Directors.

- The Mayor of Boston issued an executive order designating the One Fund as the organization that would "(i) provide a single vehicle to receive the overwhelming number of contributions which immediately began pouring in from the public in the

[128] *See* P.L.R. 9208002 (Oct. 15, 1991).
[129] *See* OVERVIEW OF INSTRUMENT/PRIVATE BENEFIT ISSUES IN IRC 501(C)(3), 1990, https://www.irs.gov/pub/irs-tege/eotopicc90.pdf.
[130] *See* G.C.M. 39,741 (June 20, 1988).
[131] *See* Abbott and McChesney, *supra* note 8 for an additional detailed discussion of this topic.

wake of the Marathon tragedy and thereby avoid the misdirection of donations to fraudulent organizations; (ii) provide the infrastructure to coordinate the collection, administration and distribution of these funds in a manner consistent with the City's interest in assisting the victims of the attacks; (iii) act as a central resource to allow those affected by the attacks to find appropriate and reputable services; and (iv) maintain the infrastructure which would allow it to respond immediately to city needs in the event of a similar tragedy, in order to lessen the burdens of government."[132]

- The City of Boston approved all final payments to the affected individuals. FOIA considerations and privacy concerns had to be addressed in the context of this approval process. Certain private information of individuals needed to be anonymized in order to be reviewed.

The One Fund Boston raised $60 million in its first few months, and all of these funds were distributed to survivors and the families of deceased victims through Kenneth Feinberg's protocol developed specifically for the One Fund. Approximately $20 million was raised and distributed in a second round of distributions administered by One Fund staff. The charitable class benefitted by the One Fund was limited to the families of those killed by the Boston Marathon bombing, individuals who lost multiple limbs, those with permanent brain damage, single amputees, those who spent at least one night in the hospital, and those who received outpatient care on the day of the bombing.[133] Any fund functioning under a model similar to the One Fund would need to have similarly well-defined protocols in place. Further, as the Fund's distributions were considered gifts, victims did not need to waive rights to sue for injuries (in contrast to the 9/11 Victim Compensation Fund).

In the case of the One Fund, the Board of Directors determined that it was closely associated with the Boston Marathon bombings in the public mind and that if the One Fund were maintained indefinitely for the benefit of victims of future tragedies, this could lead to confusion on the part of future donors. Therefore, the One Fund was dissolved in 2015. However, a charity that is granted 501(c)(3) status under the "lessening the burdens of government" standard to provide disaster relief could be continued after relief for a specific disaster has been provided under the correct set of circumstances.

Relevant rulings and primary source guidance relating to lessening the burdens of government:

- In Rev. Rul. 78-68 (January 1, 1978), an organization formed to provide bus transportation to isolated areas of a community not served by existing public

[132] *See* Executive Order Establishing The One Fund Boston, Office of the Mayor of the City of Boston (May 9. 2013).
[133] Mark Arsenault & Todd Wallack, *One Fund Payments Will Include Those Treated as Outpatients*, Boston Globe (May 15, 2013), https://perma.cc/W4TC-EJUJ (discussing the payment distribution plan from The *One Fund*).

transportation qualified as a 501(c)(3) organization that lessened the burdens of government.[134]

- In Rev. Rul. 85-1 (January 1, 1985), an organization created to assist a county's law enforcement agency in policing illegal narcotics traffic lessened the burdens of government and qualified as tax-exempt under Section 501(c)(3) of the Code.[135]

- In Rev. Rul. 85-2 (February 1, 1985), an organization which employed attorneys to provide legal advice and representation to lay volunteers and operated a training program for the volunteers on how best to represent the interests of abused and neglected children qualified as a 501(c)(3) organization that lessened the burdens of government.[136]

- In General Counsel Memorandum 39685 (December 10, 1987), an organization that created a secondary market in guaranteed student loans and administered, serviced and collected loans held by other lenders and secondary market entities met the standard for lessening the burdens of government where the organization was created by a state agency, at the request of the state's governor, to perform functions the state considered the burdens of government.[137]

- In General Counsel Memorandum 39613 (March 11, 1987), an organization formed to provide child care services to federal government employees qualified as a 501(c)(3) organization that lessened the burdens of government.[138]

- In General Counsel Memorandum 39733 (May 24, 1988), three organizations which were organized and operated to financially assist governmental units with refinancing, acquiring, constructing, improving, leasing or selling real or personal property were tax-exempt under Section 501(c)(3) of the Code as organizations that lessened the burdens of government.[139]

E. **Income Tax Treatment**. Below are some general income tax considerations for the parties involved in disaster relief charitable giving, including the donor, the charitable entity, and the recipient of charitable aid.

Donor – Donors making contributions (of money or property) to qualified tax-exempt organizations engaging in disaster relief may be able to take deductions for their donations and not be subjected to gift tax on the contributions.[140] As discussed herein,

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[134] *See* Rev. Rul. 78-68, 1978-1 C.B. 149.
[135] *See* Rev. Rul. 85-1, 1985-1 C.B. 177.
[136] *See* Rev. Rul. 85-2, 1985-1 C.B. 178.
[137] *See* G.C.M. 39,685 (Dec. 10, 1987).
[138] *See* G.C.M. 39,613 (Mar. 11, 1987).
[139] *See* G.C.M. 39,733 (May 24, 1988).
[140] For more information regarding deduction for charitable contributions, see I.R.C § 170, accompanying Treasury Regulations, and I.R.S. Publ'n 526 (Feb. 24, 2022), https://www.irs.gov/pub/irs-pdf/p526.pdf. Additionally, the donor must comply with specific requirements when contributing property. The deduction which a donor takes may

the donor cannot deduct contributions to qualified tax-exempt organizations engaging in disaster relief, however, where the contribution is earmarked for a specific individual or family.[141] If the donor receives a benefit as a result of the contribution, the donor may only deduct the contribution to the extent the contribution exceeds the value of the benefit received by the donor.[142] The usual limitations on charitable contribution deductions and requirements regarding documentation of charitable gifts apply.

Charitable Organization – Tax-exempt entities under Section 501(c) of the Code do not need to report charitable contributions as income. Organizations that do not have tax-exempt status already (or if forming a new charitable organization) may wish to follow the steps outlined above to qualify for and obtain tax-exempt status (see Section IV, "Providing for Disaster Relief"). A tax-exempt organization should also consider state-level tax consequences and exemptions. While tax-exempt organizations are generally exempt from income taxation, they are generally still required to file annual returns reporting income and expenses. They may also be required to pay tax on unrelated business taxable income.[143]

Recipient of Aid –Section 61 of the Code includes income from all sources derived unless otherwise excluded. There are a number of exclusions and exceptions. Most notable are those under Sections 102, 104, 108, 121, 123, and 139 of the Code, which are the most common bases for excluding assistance and income to disaster survivors. Different considerations apply depending on whether the aid is received from a governmental entity or a private entity or person. If aid is received from a governmental entity, the "General Welfare Exclusion," Section 139 of the Code, or other federal law may apply to exclude the aid from gross income.[144] The IRS consistently has held that payments to individuals by governmental units under social benefit programs created under legislation for the purpose of promoting the general welfare are not included in the recipient's gross income.[145]

If aid in the disaster relief context is received from a private entity (such as a 501(c)(3) charity), the gift exclusion from gross income may apply, meaning recipients are not subject to income tax on assistance received from qualified charitable organizations.[146] However, the Internal Revenue Code and regulations do not specifically define "gift" in the charitable giving context. In the past, in certain circumstances the IRS Office of

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be limited by the type of property contributed, the donor's adjusted gross income, and the type of organization receiving the property.

[141] *See* I.R.S. Publ'n 976, (Feb. 2018), https://www.irs.gov/pub/irs-pdf/p976.pdf.

[142] *See* I.R.S. Publ'n 526, (Feb. 24, 2022), https://www.irs.gov/pub/irs-pdf/p526.pdf for a detailed discussion regarding benefits received in return of charitable contributions (e.g., charity benefit events and auctions, state/local tax deductions, and membership fees and dues).

[143] *See* I.R.C. § 512(b)(3) and the Regulations thereunder.

[144] I.R.C. § 139 codifies the general welfare exclusion, but does not supplant it. Therefore, if I.R.C. § 139 does not apply, a recipient may still be able to claim exclusion under the Service's general welfare exclusion. Qualified disaster relief payments (as defined under I.R.C. §139) from any source, which reimburse or pay a recipient's specified expenses in connection with qualified disasters, are income tax-free as well as free of employment taxes. *See* I.R.S. Publ'n 3833, *supra* note 1.

[145] *See e.g.,* Rev. Rul. 74-205, 1974-1 C.B. 20; Rev. Rul. 98-19, 1998-1 C.B. 840.

[146] *See* I.R.C. § 102.

Chief Counsel has issued letters to disaster relief organizations confirming that payments from the organization will be considered gifts that are excludible from the recipients' gross income (see below). Organizations making cash payments to disaster survivors may wish to consider requesting such a letter.

Relevant rulings and primary source guidance in connection with the income tax treatment of disaster relief:

Aid from Non-Governmental Entities.

- In *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960), the United States Supreme Court stated that a gift "must proceed from a detached and disinterested generosity…out of affection, respect, admiration, charity, or like impulses."[147]

- In Rev. Rul. 99-44 (February 1, 1999), a charitable tax-exempt entity matched funds deposited into adult savings accounts and the participant was able to exclude the matched funds as a gift. Generally, a "payment made by a charity to an individual in response to the individual's needs, and does not proceed from any moral or legal duty, is motivated by detached and disinterested generosity" and therefore could be treated as a gift.[148]

- In PLR 200529004 (July 22, 2005), payments to foreign nongovernmental organizations, including payments for persons performing services for the grantee to attend and make presentations regarding a U.S. project to assist with education, were gifts.[149]

- In PLR 200442023 (October 15, 2004), an entity distributed payments to honor military pilots who had lost their lives in the line of duty, including funds for the health, education and support of families, for constructing and erecting memorials, and to establish legacy programs. The IRS determined that the payments were considered gifts to the recipients.[150]

- In PLR 9314014 (January 6, 1993), the value of services performed by a nonprofit formed to provide for respite care and transportation services to the needy was not included in the beneficiaries' gross income.[151]

- In PLR 200720017 (February 9, 2007), an employer allowed employee-victims of certain natural disasters to request time off surrendered by other employees. The donated employee leave failed to meet any exceptions recognized by the IRS and was includible in the recipient's gross income.[152]

[147] *See* Comm'r v. Duberstein, 363 U.S. 278, 80 S. Ct. 1190, 4 L. Ed. 2d 1218 (1960).
[148] *See* Rev. Rul. 99-44, 1999-2 C.B. 549.
[149] *See* P.L.R. 200529004 (Jul. 22, 2005).
[150] *See* P.L.R. 200442023 (Oct. 15, 2004).
[151] *See* P.L.R. 9314014 (Jan. 6, 1993).
[152] *See* P.L.R. 200720017 (Feb. 9, 2007).

Aid from Government and the General Welfare Exclusion.

- Rev. Rul. 2003-12 (January 1, 2003) stated that payments received under a state-sponsored program in the interest of the general welfare to reimburse reasonable and necessary medical, temporary housing, and transportation expenses incurred as a result of flood are excluded under from gross income under the general welfare exclusion.[153] While government payments are not considered gifts, payments made for purposes of disaster relief can be recognized as gifts when made by a charitable organization.

- Rev. Rul. 76-144 (January 1, 1976) determined that payments received by individuals under the Disaster Relief Act of 1974 (the "Act") to alleviate suffering and damage resulting from disaster were not included in the recipient's gross income.[154]

- Rev. Rul. 75-246 (January 1, 1975) stated the rules for qualifying for the general welfare exclusion: the payments should (a) be made from a governmental fund, (b) be for the general welfare, meaning the payments are generally based on individual or family needs, and (c) not represent compensation for services.[155]

- PLR 201816004 (April 20, 2018) provided that governmental grants are included in income unless otherwise excluded under law ("the Service has consistently held that payments made to or on behalf of individuals by governmental units under legislatively provided social benefit programs for the promotion of general welfare are not includible in a recipient's gross income" (general welfare exclusion)).[156]

F. **Considerations for International Disaster Relief.**

Generally, U.S. taxpayers may not take income tax deductions for contributions to organizations formed outside the U.S., unless permitted by a tax treaty.[157] However, U.S. 501(c)(3) organizations may operate abroad, and in the wake of a disaster occurring outside the U.S., donors may be able to make contributions to U.S.-based charitable organizations assisting with relief efforts. There are also a number of U.S. charitable organizations that make grants to foreign organizations for charitable purposes, and donors may be able to make gifts to those U.S. charitable organizations. However, a U.S. taxpayer may not claim an income tax deduction for contributions to U.S. charitable organizations that are "mere conduits"[158] of foreign entities. In other words, the donor cannot earmark funds for the use of the foreign organization. Rather, the

[153] *See* Rev. Rul. 2003-12, 2003-1 C.B. 283.
[154] *See* Rev. Rul. 76-144; 1976-1 C.B. 17.
[155] *See* Rev. Rul. 75-246; 1975-1 C.B. 24.
[156] *See* P.L.R. 201816004 (Apr. 20. 2018).
[157] *See* I.R.S. Publ'n 526 (Feb. 24, 2022), https://www.irs.gov/pub/irs-pdf/p526.pdf; *see also* I.R.S Publ'n 3833, *supra* note 1.
[158] *See* Rev. Rul. 63-252, 1963-2 C.B. 101.

U.S. charity must make an independent decision to make one or more grants to the foreign entities.

Grants by U.S. charitable organizations for use abroad must comply with a variety of requirements. Certain of these requirements apply to all U.S. 501(c)(3) organizations, and additional requirements and restrictions apply to 501(c)(3)s that are classified as private foundations.[159] Additionally, foreign aid from U.S.-based charities to support disaster relief must comply with applicable anti-terrorism regulations, trade sanctions and embargoes. New organizations formed to assist with foreign disaster relief efforts must comply with these rules in addition to those discussed above for U.S. relief efforts.

V. EMPLOYER PUBLIC CHARITY DISASTER RELIEF AND EMERGENCY HARDSHIP ASSISTANCE PROGRAM

A. **History.**

1. Historically, the IRS did not take a favorable stance towards employer-sponsored organizations or programs providing assistance, including disaster relief, to employees. This stems from the requirement that all charitable organizations provide a public, rather than a private, benefit. See IRS Pub. 3833.

2. The IRS then provided substantial guidance, the most comprehensive of which is an article in the 1999 edition of the Continuing Professional Education Text (the "1999 CPE Text"). The 1999 CPE Text set forth a 14-factor test, which is discussed below, applicable to general employee assistance aid provided by an employer sponsored public charity.[160]

3. Since the enactment of the Act,[161] an employer-sponsored public charity can provide disaster or employee emergency hardship aid to employees (or members of their families) without having to satisfy the 14-factor set applicable to general employee assistance aid.

4. Under this Act, an employer-controlled public charity will be entitled to a presumption that it is acting in further of its exempt purposes, provided that the class of beneficiaries is large or indefinite and the recipients of relief are selected based on an objective determination of need by an independent committee or using an adequate substitution procedure.

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[159] For a detailed discussion of these rules, see Susan L. Abbott and Laurie L. O'Donnell, *International Philanthropy*, Taxation of Exempts (May/June 2016).

[160] Fiscal 1999 Continuing Professional Education Text for Exempt Organizations, Topic K, "Disaster Relief and Emergency Hardship Programs."

[161] In response to the Act, the IRS released a publication entitled "Disaster Relief: Providing Assistance Through Charitable Organizations."

5. Presumably, if a public charity chooses not to satisfy the requirements of the presumption, it may still be operated in a permissible manner if it satisfies the 14-factor test in the 1999 CPE Text.[162]

6. Generally, when an employer provides benefits, an employee must include such benefits in gross income under Section 102(c) of the Code. But the nexus between the employer and employee is deemed broken if the disaster or emergency hardship payments are made pursuant to this Act. In this case, Section 102(a) of the Code, subject to certain conditions, would exclude an otherwise includable fringe benefit from gross income. The conditions are designed to ensure that employment is merely an initial qualifier for eligibility, that the ultimate recipients are not chosen based on employment related factors, and that those responsible for selecting recipients are independent from the employer.

B. **General Employee Hardship Assistance Program.** Following are the conditions under which a public charity established by an employer may administer an employer-related disaster relief or emergency hardship program per the 1999 CPE Text.

1. The program is operated by a public charity rather than by any employer-related private foundation;

2. The organization is not excessively controlled by the employer;

3. The organization is not funded by the employer in a manner that will cause it to be classified as a private foundation;

4. The organization does not fulfill a legal obligation of the employer, such as a program that is part of a collective bargaining agreement or a program that is part of a written plan that provides life, sick, accident, supplemental unemployment compensation or similar benefits;

5. The organization's beneficiaries comprise a charitable class that is open-ended, of sufficient size, and that is not organized or operated to benefit particular individuals;

6. Other than as an initial qualifier, employment is not a relevant factor in the application or selection process, or in the amount or type of assistance provided (e.g., employee's position, length of service, continued employment, etc.);

7. The organization establishes a committee to administer the program consisting of persons who, aside from serving on the committee, have no financial interest in the employer; or the committee consists of persons representing a broad spectrum of employees who understand that they are acting in their personal capacities as agents of the organization rather than as representatives of the employer;

[162] Burnstein, "Charities and Disaster Relief for September 11 and Beyond," 13 Tax'n of Exempts 283, 297 (2002).

8. The organization establishes specific written criteria for the application, selection and disbursement of funds, including minimal information for immediate relief and more detailed information for more long-term assistance;

9. The selection process must be objective and nondiscriminatory;

10. The program is not used by the employer or the organization to recruit employees or to induce employees to continue their employment or otherwise to follow a course of action sought by the employer;

11. The organization informs all employees of the corporation that disaster relief and emergency hardship funds are available, including the criteria for application and selection;

12. The organization will accept voluntary contributions from employees or others, but it will not accept contributions earmarked for specific individuals;

13. The organization will maintain records of the assistance granted as required by Rev. Rul. 56-304.

C. **Presumption After the Act.**

1. See Sections D and E of Part VII below for the conditions applicable to an employer sponsored public charity providing disaster relief since enactment of the Act.

2. Unlike employer sponsored private foundations, discussed below, employer sponsored public charities will be entitled to the presumption whether or not the disaster is a "qualified disaster' under Section 139 of the Code.

VI. EMPLOYER-SPONSORED DONOR ADVISED FUNDS

A**. General.**

1. Certain community foundations and other public charities maintain separate funds or accounts to receive contributions from individual donors. These individual donors then are given advisory privileges over investment or distribution of the donated funds.[163]

2. In general, these separate funds or account, known as donor advised funds, can make grants to Section 501(c)(3) public charities and, under certain conditions, to other organizations for charitable purposes, but cannot make grants to individual persons.

[163] *See* I.R.S. Publ'n 3833, *supra* note 1.

3. There is an exception, however, for certain employer-related funds or accounts established to benefit employees and their family members who are victims of a qualified disaster.

B. **Requirements.** A donor advised fund can make grants to employees and their family members in the following circumstances:[164]

1. The fund serves the single identified purpose of providing relief from one or more qualified disasters.

2. The fund serves a charitable class.

3. Recipients of grants are selected based upon objective determination of need.

4. The selection of recipients of grants is made using either an independent selection committee or adequate substitute procedures to ensure that any benefit to the employer is incidental and tenuous (the selection committee is considered independent if a majority of its members consists of persons who are not in a position to exercise substantial influence over the employer's affairs).

5. No payment is made from the fund to or for the benefit of any director, officer, or trustee of the sponsoring community foundation or public charity, or members of the fund's committee; and

6. The fund maintains adequate records to demonstrate the recipients' need for disaster assistance provided.

VII. EMPLOYER-SPONSORED PRIVATE FOUNDATIONS

A. **Private Foundation Issues.**

1. Like public charities, private foundations can make need-based distributions to victims of disasters or to the poor or distressed.

2. Several issues arise, however, when an employer-sponsored private foundation provides aid that favors the employees of the sponsoring employer because of certain rules applicable to private foundations, which make it more difficult to provide aid to employees.

3. Private foundations are subject to Section 4941(d)(1) of the Code, which prohibits "self-dealing" by a private foundation, and Section 4945 of the Code, which prohibits "taxable expenditures" by a private foundation. Violations are subject to significant penalty taxes.

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[164] *Id.,* page 17.

a. The term "self-dealing" means direct and indirect acts between a private foundation and disqualified persons, including the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of the private foundation.

b. Certain transactions between a private foundation and a disqualified person are not considered self-dealing if the benefit to a disqualified person from the foundation's use of its income or assets is only incidental and/or tenuous. Treas. Reg. § 53.4941(d)-2(f)(2).

c. The term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than a charitable purpose specified in Section 170(c)(2)(B) of the Code. An employer-sponsored disaster relief program operated by a private foundation that significantly furthers the private interests of the employer will constitute a taxable expenditure.

d. For example, in *Calloway Family Association, Inc. v. Commissioner*, 71 T.C. 340 (1978), the Tax Court found that an organization formed to study immigration to and migration within the United States focused on the Calloway's own family history and genealogy and impermissibly furthered private interests.

e. Also, in *Ohio Teamsters Educational and Safety Training Trust Fund*, 77 T.C. 189 (1981), *aff'd* 692 F.2d 432 (6th Cir. 1982), a scholarship fund set up pursuant to a collective bargaining agreement between a union and an association was found to be operated impermissibly to satisfy the employer's negotiated obligation to its employees in securing their services.

4. A company sponsored private foundation, however, *can* provide "qualified disaster relief payments" in the event of a "qualified disaster" to employees (or members of their families) as long as the employer receives no impermissible private benefit.

B. **Qualified Disaster.**[165]

1. The aid must be in response to "qualified disaster."

2. A "qualified disaster" is defined as a disaster that results from terrorist or military actions; results from an accident involving a common carrier; is a presidentially declared disaster; or is an event that the Secretary of the Treasury determines is catastrophic.

C. **Qualified Disaster Relief Payments.**

1. The payments must be "qualified disaster relief payments."

2. Such payments include those for reasonable and necessary personal, family, living or funeral expenses incurred as a result of a qualified disaster; reasonable

[165] *Id.,* page *15.*

and necessary expenses incurred for the repair or rehabilitation of a personal residence (which can be rented or owned) due to a qualified disaster; and reasonable and necessary expenses incurred for the repair or replacement of the contents of a personal residence due to a qualified disaster.

3. Qualified disaster relief payments *do not* include payments for expenses otherwise paid for by insurance or other reimbursements; or income replacement payments, such as payments for lost wages, lost business income, or unemployment compensation.

D**. <u>No Impermissible Benefit to Employer</u>.** The program cannot impermissibly benefit the employer. To ensure a program is not impermissibly serving the related employer, the following requirements must be met:[166]

1. The class of beneficiaries must be large or indefinite (a "charitable class").

a. There is no clear guidance as to when a class of beneficiaries is sufficiently large or indefinite such that providing aid to members of such class benefits the community as whole. It appears, however, that if the class of beneficiaries is open-ended to include present and future victims, the class should be sufficiently large or indefinite.

b. If an organization is found to be a mutual benefit organization, it will not be deemed to be benefiting a charitable class. A mutual benefit organization primarily serves the private interest of their members rather than the common good and general welfare of the community.

2. The recipients must be selected based on an objective determination of need; and

3. The recipients must be selected by an independent selection committee or adequate substitute procedures must be in place to ensure that any benefit to the employer is incidental and tenuous, and the basis on which recipients are selected must be documented.

a. The foundation's selection committee is "independent" if a majority of the members of the committee consists of persons who are not in a position to exercise substantial influence over the affairs of the employer.

b. Documentation should be similar to that described in the 14-factor test of the 1999 CPE Text.

4. If the above requirements are met, the private foundation's payments in response to a qualified disaster are presumed to be made for charitable purposes and

[166] *Id*., pages 17-18.

do not result in prohibited self-dealing merely because the recipient is an employee (or family member of an employee) of the employer-sponsor,.

5. This presumption *does not apply* to payments that would otherwise constitute self-dealing and subject the organization to excise taxes.

a. For example, the presumption does not apply to payments made to or for the benefit of individuals who are directors, officers, or trustees of the private foundations or members of the private foundation's selection committee.

b. The IRS may still review the facts and circumstances to ensure that any benefit to the employer is tenuous and incidental.

c. For example, a program may not be used to induce employees to follow a course of action sought by the employer or designed to relieve the employer of a legal obligation for employee benefits.

5. If employers and other organizations make "qualified disaster relief payments" directly to employees, such payments are not considered taxable income to the employee under Section 139 of the Code.

VIII. LEAVE DONATION PROGRAMS

A. **General.**

1. Generally, an individual who earns paid time off and has the choice to receive it as income (gets paid for the unused leave time) or dispose of it (donates it to a leave bank or similar leave-sharing arrangement) is still obligated to pay income taxes on the value of the time regardless of whether he or she decides to donate the time.

2. The IRS, however, allows for certain exceptions in which leave can be donated without negative income tax consequences to the donor.

3. An exception applies for leave deposited in an employer-sponsored leave bank for use by other employees who have been adversely affected by a major disaster.

a. For purposes of the plan, an employee is considered to be adversely affected by a major disaster if the disaster has caused severe hardship to the employee or a family member of the employee that requires the employee to be absent from work.

b. This employer-sponsored leave bank must meet the requirements set forth in IRS Notice 2006-59 in order for donations to qualify for this exception. In this event, the donor will not realize income on the donated leave time (and the donor also is not entitled to claim a charitable deduction for the donation).

B. **IRS Notice 2006-59.**

1. For purposes of this notice, a major disaster leave-sharing plan is a written plan meeting each of the following requirements:

a. The plan allows a leave donor to deposit accrued leave in an employer sponsored leave bank for use by other employees who have been adversely affected by a major disaster. For purposes of the plan, an employee is considered to be adversely affected by a major disaster if the disaster has caused severe hardship to the employee or a family member of the employee that requires the employee to be absent from work.

b. The plan does not allow a leave donor to deposit leave for transfer to a specific leave recipient.

c. The amount of leave that may be donated by a leave donor in any year generally does not exceed the maximum amount of leave that an employee normally accrues during the year.

d. A leave recipient may receive paid leave (at his or her normal rate of compensation) from leave deposited in the leave bank. Each leave recipient must use this leave for purposes related to the major disaster.

e. The plan adopts a reasonable limit, based on the severity of the disaster, on the period of time after the major disaster occurs during which a leave donor may deposit the leave in the leave bank, and a leave recipient must use the leave received from the leave bank.

f. A leave recipient may not convert leave received under the plan into cash in lieu of using the leave. However, a leave recipient may use leave received under the plan to eliminate a negative leave balance that arose from leave that was advanced to the leave recipient because of the effects of the major disaster. A leave recipient also may substitute leave received under the plan for leave without pay used because of the major disaster.

g. The employer must make a reasonable determination, based on need, as to how much leave each approved leave recipient may receive under the leave-sharing plan.

h. Leave deposited on account of one major disaster may be used only for employees affected by that major disaster. Except for an amount so small as to make accounting for it unreasonable or administratively impracticable, any leave deposited under a major disaster leave-sharing plan that is not used by leave recipients by the end of the period specified in paragraph e, above, must be returned within a reasonable period of time to the leave donors (or, at the employer's option, to those leave donors who are still employed by the employer) so that the donor will be able to use the leave. The amount of leave returned to each leave donor must be in the same proportion as the amount of leave donated by the leave donor bears to the total amount of leave donated on account of that major disaster.

IX. INDIVIDUAL GIFTS

Individuals can also help victims of disaster or hardship by making gifts directly to victims. This type of assistance does not qualify as a tax-deductible contribution since a qualified charitable organization is not the recipient of the gift. However, individual recipients of gifts are generally not subject to federal income tax on the value of the gift. The donor of a gift made directly to an individual is not subject to federal gift tax unless the total gifts made in a year exceed the annual exclusion amount.[167]

More information on the taxability of gifts can be found in IRS Publication 559.

X. CROWDFUNDING

Crowdfunding is the practice of soliciting financial contributions from a large number of people, especially from the online community.[168] Compassionate or charitable crowdfunding typically takes one of two forms: (1) crowdfunding to raise funds for qualified not-for-profit organizations, and (2) crowdfunding for the private benefit of one or more individuals. The second category of charitable crowdfunding will be the focus of this section.

A. **Initial Considerations**.[169] Individuals or organizations who choose to donate to a crowdfunding campaign should understand some of the realities of their generosity, including:

- The donor has no control over the donated funds once the transaction is completed;
- In most cases there is no income tax deduction;
- The donor has no authority to request an accounting of how the funds are ultimately distributed;
- The creator of the campaign has no responsibility to report how the funds are spent;
- It may not be easy to verify the authenticity of the appeal or to identify fraud in a new campaign, although when fraud is discovered, donors may be repaid if there are funds available;
- Recipients of public benefits may be unaware that crowdfunding donations may be considered resources for eligibility purposes; and
- Crowdfunding donations may be available to the recipient's creditors.

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[167] *See* I.R.S. Publ'n 559 for more information on the taxability of gifts.
[168] *See* www.merriam-webster.com/dictionary/crowdfunding.
[169] Karen Boxx, *The Go-Fund-Me Revolution: How a Uniform Act Could Protect Donors, Fundraisers, and Beneficiaries of Crowdfunding Campaigns*, page 3.

B. **Income Tax Implications**.[170] There is little official guidance on the tax implications of charitable crowdfunding. In Information Letter 2016-0036 (June 24, 2016), the IRS explains general rules that may apply to the receipt of funds via a crowdfunding platform.

- In Information Letter 2016-0036, the IRS notes that under the broad rule of Section 61 of the Code, crowdsourced funds are likely to be taxable gross income to the recipient unless the funds are: (i) a loan that must be repaid, (ii) capital contributions of equity, or (iii) "gifts made out of detached generosity and without any "quid pro quo."

- The Information Letter also concludes that crowdfunding revenues are taxable if they are received for services rendered or represent gains from property sales. Thus, if the recipient or fund creator promises a good or service in return for a contribution,[171] depending on the value of the good or service, the IRS may consider all or some part of the funds raised to be sales revenue, making that portion of the funds taxable income with accompanying federal and state tax liability.[172]

- The Information Letter stresses that a crowdfunding "gift made out of detached generosity" and with no quid pro quo is not income to the recipient. Typically, sites such as GoFundMe process money raised through third-party settlement entities. IRS rules require the issuance of a Form 1099-K for settlement of third-party payment transactions if gross payments exceed $20,000 or there are more than 200 such transactions.[173] While a 1099-K does not mean that taxes are owed, if a 1099-K is issued, it should be addressed on the recipient's income tax return.

    - Example: A family that raised $50,000 for the daughter's cancer treatment on GoFundMe was issued an IRS notice for $19,000 of back taxes, alleging that the $50,000 raised was income to the family.[174] Thus, it is best to address the 1099-K on an income tax return rather than risk a notice of deficiency.[175]

C. **Transfer Tax Implications**.[176] The IRS has acknowledged that a gift can be made to a crowdfunding campaign but has yet to provide guidance on the gift tax implications of doing so. Crowdfunding campaigns can be structured in a variety of ways, and some pose more transfer tax challenges than others. Issues of concern include: (i) who is the beneficiary of the crowdfunding campaign for transfer tax purposes, (ii) whether the generous refund policy on sites such as GoFundMe makes a gift incomplete, (iii) whether gifts to crowdfunding campaigns are gifts of a present interest qualifying for the annual exclusion, and (iv) whether gifts to

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[170] Karin Prangley, *The Go-Fund-Me Revolution: How a Uniform Act Could Protect Donors, Fundraisers, and Beneficiaries of Crowdfunding Campaigns (Section III).*

[171] *See, e.g.*, https://www.gofundme.com/calkinscolombia/donate?amt=10, a campaign to raise funds to teach abroad in Colombia promising small souvenirs in return for donations.

[172] *See* Prangley, *supra* note 169, page 9.

[173] www.irs.gov/businesses/understanding-your-1099-k.

[174] http://www.ketv.com/article/irs-cancer-survivor-owes-19-000-in-taxes-from- donations/7652336.

[175] Prangley, *supra* note 169, page 10.

[176] *Id*., pages 11-15.

crowdfunding campaigns benefitting someone more than 37 ½ years younger than the donor are direct skips that also qualify for the annual exclusion from the generation-skipping transfer ("GST") tax.

- Who is the beneficiary of the gift? The organizer may have the absolute right to withdraw the funds for him or herself, the intended recipient may not know that a crowdfunding campaign is being held for his or her benefit, or the recipient may refuse acceptance of the funds. For gift tax purposes, does a donor to the crowdfunding campaign make a gift to the campaign organizer or to the beneficiary/intended recipient?

    - Under Section 2511(a) of the Code, a gift can be direct or indirect. Senate and House Reports to Section 2511 explain, "the terms 'property,' 'transfer,' 'gift,' and 'indirectly' are used in the broadest and most comprehensive sense."[177] A gift is also presumed to be accepted unless it is expressly refused.[178] Thus, it seems that if a donation is made to a crowdfunding campaign organized by A for the benefit of B, it is probably an indirect gift to B.[179]

- Refund Policies. A completed gift for gift tax purposes requires: (i) a donor competent to make a gift, (ii) a donee capable of taking the gift, (3) a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself of title, dominion and control of the subject matter of the gift, (4) the irrevocable transfer of the present legal title and of dominion and control of the entire gift to the donee so that the donor can exercise no further act of dominion and control over it, (5) delivery to the donee, and (6) acceptance of the gift by the donee.[180] For example, a gift made of funds made through a personal check is not complete until (i) the check is paid by the drawee bank when first presented to the draw bank for payment, (ii) the donor intended to make a gift, (iii) the donor remains alive when the check is paid, (iv) the check has been unconditionally delivered, and (v) the check has been deposited, cashed or presented in the calendar year for which completed gift treatment is sought.[181] Under this reasoning, it appears that a gift to a GoFundMe campaign should not be complete until payment is deposited, cashed or presented to the campaign beneficiary and the opportunity for the donor to obtain a refund is extinguished.[182]

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[177] S. Rep. No. 665, 72d Cong., 1st Sess., 39 (1932); H. R. Rep. No. 708, 72d Cong., 1st Sess., 27 (1932) (cited in *Jewett v. Comm'r*, 455 U.S. 305 (1982)).

[178] *Routzahn v. Brown*, 95 F.2d 766 (6th Cir. 1938).

[179] *See also* Shenkman, Krooks and Blattmachr, *Crowdsource Funding to Help Victims of the Las Vegas Massacre*, available at https://www.aicpa.org/content/dam/aicpa/interestareas/personalfinancialplanning/resources/taxplanning/downloadabledocuments/crowdsource-funding- lasvegas.pdf ("whether or not the campaign organizer holds the funds for an eventual recipient, or a trust for the eventual recipient, should not affect the gift tax consequences").

[180] *Towe v. U.S.*, 58 AFTR 2d 86-6317 (S. Dis. Tex. 1986).

[181] Rev. Rul. 96-56, 1996-50 IRB 7, modifying Rev. Rul. 67-396, 1967-2 CB 351.

[182] Prangley, *supra* note 169, page 13. This is true of gifts to individuals, but there is an exception for gifts to charity. In that case, it's complete when delivered, not when cashed. Treas. Reg 1.170A-1b.

- Present Interest Requirement. A gift must convey a present interest to qualify for the annual exclusion from the gift tax.[183] However, if the campaign owner and the beneficiary are different individuals, the beneficiary may not have an immediate right to possession of the campaign funds. If the crowdfunding campaign is not a gift of a present interest, some unfortunate administrative complexities arise.

    - If the gift is not of a present interest, then the annual exclusion is not available.

    - If the annual exclusion is not available, the donor would need to file a gift tax return claiming use of his or her lifetime exemption (applicable exclusion amount), which serves as a disincentive for individuals to give via crowdfunding campaigns.[184]

- GST Tax Implications. Section 2642 of the Code is the generation-skipping transfer tax (GST) equivalent of the annual exclusion and provides that in the case of a direct skip (such as outright transfer to a skip person) which is a nontaxable gift, the inclusion ratio shall be zero (in other words, the transfer is not a taxable transfer for GST purposes). A nontaxable gift includes a gift that qualifies for the gift tax annual exclusion and a qualified payment of education and medical expenses. If the gift does not qualify for the annual exclusion from the gift tax because it is not a gift of a present interest, it would not qualify for the GST annual exclusion either.[185]

D. **Crowdfunding Checklist:**

- Who created the campaign?

- Is the intended beneficiary aware of the campaign?

- Is the intended beneficiary the recipient of public benefits that may be affected by the funds raised?

- What is the purpose of the campaign?

- What is the financial goal of the campaign?

- To whom will the funds be paid?

- If the intended beneficiary is not the campaign organizer, will the organizer be using funds on behalf of the beneficiary, and if so, are there limits on the organizer's discretion? Will the funds be placed in a trust or other protective

[183] See I.R.S. Publ'n 559 (the annual exclusion is $16,000 as of 2022).
[184] Prangley, *supra* note 169, pages 14-15.
[185] Prangley, *supra* note 169, page 15.

device? Will the organizer hold the funds in such a way to expose them to the organizer's creditors?

- If the campaign organizer will receive the funds directly, how will he or she distribute the funds to the intended beneficiary?
- Does the campaign specify what will happen to any excess or unused funds?

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