

Legal Considerations for Nonprofits Funding Internships at For-Profit Businesses

Certain industries only offer unpaid internships, which provide valuable training and networking opportunities but disproportionately limit participation of low-income people and people of color.¹ In response, a growing number of nonprofits are exploring whether they can legally provide grants or stipends to help low-income students access otherwise unpaid internships at for-profit businesses.

Nonprofit organizations with 501(c)(3) tax-exempt status should be aware that the Internal Revenue Service (IRS) has strict rules against using tax-exempt dollars to excessively benefit private businesses and individuals.² A nonprofit organization providing a grant to an intern placed with a private company may risk conferring a benefit on the host company, and the IRS has recognized that some benefits to private individuals or for-profit companies are a common and unavoidable byproduct of the pursuit of a charitable mission. Such private benefits are acceptable so long as they are incidental, not excessive.³ Determining whether a given benefit is more than incidental is a fact-specific inquiry. A nonprofit organization should work with an attorney to conduct this analysis.

An organization running afoul of private benefit rules potentially jeopardizes its tax-exempt status. This Legal Alert discusses some of the issues nonprofit organizations should consider to ensure compliance with IRS requirements when providing grants to allow certain students to participate in unpaid internships at for-profit businesses.⁴ Note that this Legal Alert only focuses on concerns relevant to public charities, not private foundations or other types of tax-exempt organizations.

Amend governing documents if necessary

The nonprofit organization should ensure that its governing documents allow it to make grants to the charitable class who will benefit from the internships. For example, if the Certificate of Incorporation limits the organization's purposes to serving a particular neighborhood, an amendment would be necessary if the internships will be available to students citywide or nationally.

Define eligibility and selection criteria for the grants

The nonprofit organization must make sure that the group of eligible applicants is broad or "indefinite" enough to avoid the appearance that the program is set up to serve particular individuals.⁵ For instance, the nonprofit may specify that the internships will be available to all low-income students of color in a

¹ <https://www.aacu.org/publications-research/periodicals/reducing-internship-inequity>

² See IRS, *Private Benefit Under 501(c)(3)*, 2001 EO CPE Text, <https://www.irs.gov/pub/irs-tege/eotopich01.pdf>.

³ To be deemed permissible, a private benefit must be incidental from both a qualitative and quantitative standpoint, meaning, respectively, that the private benefit is necessary to carry out the nonprofit's charitable purpose and that the benefit is only insubstantial in amount.

⁴ Although the focus of this Legal Alert is sponsorship of unpaid interns at for-profit businesses, many of the issues and considerations discussed here still apply if a sponsored student is to intern at a not-for-profit entity.

⁵ The IRS's guidance on what constitutes a "charitable class" suggests that the group of persons who may benefit must be either large enough or sufficiently indefinite so that no pre-selection of recipients can occur, and so that the grants benefit the greater community, not just the selected recipients. See IRS, Publication 3833, *Disaster Relief, Providing Assistance Through Charitable Organizations*, <https://www.irs.gov/pub/irs-pdf/p3833.pdf>

particular city, county, or state, thereby ensuring that the program is sufficiently open-ended and not structured to benefit any particular student or students.

The criteria used to select individual interns should be related to the purposes of the grant (e.g., providing time-limited career development opportunities for students of color to build practical skills and eliminating discrimination in certain professional industries). For instance, the nonprofit organization could consider factors that reflect applicants' qualifications and career interests, or their demonstrated financial need, rather than the host company's need for labor.⁶

The nonprofit organization also should be careful to avoid conflicts of interest. It should, for instance, avoid selecting applicants related to its directors and officers, to people involved with the selection process, or to owners, directors, employees, or officers of any of the businesses at which the grant recipients will intern.

Determine which for-profit businesses are eligible to serve as hosts

The nonprofit organization should make sure that the pool of eligible host businesses is broad enough to avoid any implication that the purpose of the program is to benefit particular businesses. This is particularly important if any of the host businesses are also major contributors to the nonprofit organization.

Establish procedures for selecting interns and host businesses

The nonprofit organization should establish objective and nondiscriminatory procedures. Here are some steps nonprofits can take to increase the likelihood that their program will pass muster:

- Establish a selection committee to review the applications. Ideally, the members of the selection committee will not include anyone associated with the for-profit businesses that may host the interns.
- The selection committee should not know whether a company at which a candidate proposes to intern has been asked to contribute to the nonprofit or has made such contributions.
- While a nonprofit organization may reimburse a for-profit for some actual costs related to the internship program, the nonprofit organization should not accept any charitable contributions from a company that are contingent on the placement of an intern with that organization. Furthermore, the nonprofit organization should ensure that support from companies hosting interns is not the organization's primary source of funding. If most of the nonprofit's support comes from a small group of for-profit businesses that will benefit from the internship grant program, questions about impermissible private benefits may be raised.

Incorporate training elements into the internship grant program

Including an educational component in the internship program can help ensure that the program is designed primarily for the benefit of the students, not the hosting businesses. For instance, the nonprofit organization may require the host businesses to provide training similar to what the students would receive in an educational environment. The nonprofit organization may also consider providing the selected students with additional coaching, training, and mentorship to supplement the educational experience that the internship alone would provide.

⁶ Some of the factors that nonprofits can consider include students' prior academic performance, community involvement or extracurricular activities, statements of the students' career plans, and letters of recommendation.

Consider employment law consequences of pay structure

In addition to the private benefit issues, a nonprofit organization providing a grant to a student to access an unpaid internship runs two employment law risks.

First, the government may classify the student working at a private company as an employee and not an intern, triggering various additional employment law requirements (e.g. overtime pay and minimum wage).⁷

Second, if the intern is classified as an employee, a nonprofit organization that pays an intern for work at a private company risks being classified as a joint employer that becomes jointly and severally liable for payment of wages.⁸

The nonprofit organization should work with an attorney to structure the internship program so that the intern receives useful training and does not perform work that would otherwise be done by regular employees. Any payment to the intern should be structured purely as an incentive that allows the student to financially access the internship and not tied to hours worked.

This memo is meant to provide general information only, not legal advice. Please contact Rafi Stern at Lawyers Alliance for New York at rstern@lawyersalliance.org or visit our website, www.lawyersalliance.org, for further information. Lawyers Alliance would also like to thank Peter F. Martin, a Legal Fellow working with Lawyers Alliance through NYU School of Law's National Center on Philanthropy and the Law, and Amy Zhang of Columbia Law School for their assistance in preparing this Legal Alert.

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⁷ Note, though, that interns are protected under New York law by the same anti-discrimination protections as employees: <https://codes.findlaw.com/ny/executive-law/exc-sect-296-c.html>.

⁸ See: <https://www.dol.gov/agencies/whd/flsa/2020-joint-employment/fact-sheet>.