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# Providing Financial Support to Individuals

For many people, giving money to those in need represents one of the most obvious and basic forms of charity. Nonprofits engaged in a range of charitable activities may want to explore opportunities to provide financial assistance as part of their work. However, many nonprofits have questions about whether providing cash assistance to individuals is permissible and, if so, what rules need to be followed when implementing a cash assistance program.

This Legal Alert discusses how a nonprofit organization can design and implement a financial assistance program for individuals that furthers the organization's charitable mission while maintaining its tax-exempt status. While relevant guidance has largely focused specifically on cash assistance, the general principles should apply equally to the provision of cash equivalents (like gift cards) or other forms of financial assistance (like paying someone's medical bills for them).

## Designing and Implementing a Financial Assistance Program

### *Overview and Legal Checklist*

- ✓ Is the financial assistance program within your charitable mission?
  - Check the purposes clause of your certificate of incorporation.
- ✓ Who is eligible to receive financial assistance?
  - Define your charitable class and eligibility criteria.
  - Ensure a large pool of possible beneficiaries.
  - Be cautious about benefits to insiders!
- ✓ Are you maintaining appropriate documentation?
  - Keep records showing the names and addresses of recipients; how each recipient was selected; the amount distributed and purpose; and any relationships between the recipient and the organization and insiders.
- ✓ Do you need to report the program on your Form 990?
  - Check Schedules I, F and O.

### *Reviewing Charitable Purpose*

501(c)(3) organizations may provide direct financial support to individuals so long as such support is "made on a true charitable basis in furtherance of the purposes for which [such charities] are organized."[1] Thus, the first question for an organization that is considering implementing a program of

[1] *See* Revenue Ruling 56-304, 1956-2 C.B. 306, available at https://www.irs.gov/pub/irs-tege/rr56_304.pdf (hereinafter "**Rev. Rul. 56-304**").

cash assistance to individuals is how and whether providing such financial assistance furthers the organization's charitable purpose.

A nonprofit's charitable purpose is set forth in the "purposes clause" of its certificate of incorporation. The "purposes clause" does not need to identify the *means* for achieving the organization's purpose – that is, it is not necessary for cash assistance to individuals to be mentioned specifically – but it should be clear that the proposed activity will further the organization's stated purpose or mission.

By way of example, a cash assistance program may be appropriate for an organization whose certificate identifies its charitable purpose as alleviating poverty and/or assisting individuals experiencing homelessness. However, such a program may not be appropriate for an organization whose certificate indicates it is organized for the purpose of beautifying a local park.

If an organization's certificate does not appear to encompass a cash assistance program and its Board believes that such a program would be an appropriate and helpful expansion of the organization's mission, the organization may need to amend its certificate of incorporation to revise its purposes clause.[2]

Newly-forming organizations that plan to provide financial assistance to individuals should similarly ensure that their purposes clauses are drafted to cover such work when filing their certificate of incorporation. They should also indicate such planned activities on their Form 1023 or Form 1023-EZ[3], as applicable, when applying for tax-exempt status from the Internal Revenue Service ("IRS").

*Establishing Criteria for Beneficiaries*

After confirming that a financial assistance program would be in furtherance of an organization's charitable purposes, the next step is to identify the charitable class that will be eligible for the assistance and the criteria that will be used to select individual recipients, which should be based on an objective determination of need.[4]

The selection criteria should be clear, objective, documented, and consistently applied.

In addition, while the criteria should be tailored to the organization's mission, they should not be so narrow or specific as to only allow an identifiable or closed group to qualify for the benefit. If this is the case, an organization may run into issues with impermissible private benefit as a result of having a charitable class that is too small.[5] For example, a cash assistance program that is open to all eligible

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[2] For more information on this process for New York not-for-profit corporations, see our Legal Alert: [Changing the Purposes Clause of a New York Not-for-Profit Corporation](#).

[3] *See*, for example, Form 1023-EZ: Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code (Rev. Apr. 2021), Part III, Questions 7 ("Do you or will you donate funds to or pay expenses for individual(s)?"); 8 ("Do you or will you conduct activities or provide grants or other assistance to individual(s) or organization(s) outside the United States?"); and 12 ("Do you or will you provide disaster relief?").

[4] *See* Exempt Organizations Technical Instruction Program for FY 2003: *Disaster Relief – Current Developments*, Janet Gitterman and Marvin Friedlander (2003 EO CPE Text), available at: https://www.irs.gov/pub/irs-tege/eotopicm03.pdf (hereinafter "**EO CPE Text**").

[5] *See Id*.

individuals in a city or a large neighborhood may be appropriate; however, a program that is limited to individuals living on a particular street or in a specific building likely would not be.

Similarly, an organization cannot implement a special initiative to benefit pre-selected individuals. Just as an individual donor would not be able to claim a tax deduction for contributions made to a private GoFundMe to assist a specific family after a tragedy, organizations cannot pre-select individuals for aid and then fundraise tax-deductible donations earmarked to support them.[6] "Adopt-a-family" or similar programs may be permissible if the families or other recipients are selected from an appropriately large charitable class using objective criteria.[7]

Finally, when identifying eligibility criteria and the ultimate recipients for financial assistance, an organization should be very careful to avoid engaging in impermissible financial transactions benefiting the organization's insiders and decision-makers. Impermissible private inurement occurs when a nonprofit organization is improperly benefiting private interests, such as the interests of the founder, officers, directors, major donors, family members of any such "insiders", or entities controlled directly or indirectly by such "insiders".[8] If the "insiders" are part of the larger charitable class served by the organization and they are treated the same way as all other possible beneficiaries, it may be permissible for the organization to provide financial assistance to them.[9] However, the organization should ensure it is following its conflict of interest policy in connection with any such transaction, and organizations can expect that any cash assistance provided to these types of "insiders" may be subject to heightened scrutiny by the IRS or other charitable regulators in the event of any audit. Thus , consulting with an attorney before moving forward with any grants to insiders is advisable.

*Maintaining Appropriate Documentation*

Organizations should ensure that they are collecting and maintaining appropriate documentation regarding all recipients and the cash assistance distributed, including, at a minimum, the following records:

- Name and address of each recipient;
- Amount distributed to each recipient;
- Purpose for which funds were distributed;
- How the recipient was selected; and

[6] *See* IRS Publication 3833: *Disaster Relief, Providing Assistance Through Charitable Organizations*, available at: https://www.irs.gov/pub/irs-pdf/p3833.pdf (hereinafter "**Publication 3833**").
[7] *See* EO CPE Text.
[8] The IRS has provided additional guidance on employer-sponsored programs that benefit a nonprofit's own employees. For more information, *see* EO CPE Text.
[9] *See*, for example, § 102(a)(24) of the New York Not-for-Profit Corporation Law, which excludes certain transactions with insiders from the definition of "related party transactions", including transactions which "constitute[] a benefit provided to a related party solely as a member of a class of the beneficiaries that the corporation intends to benefit as part of the accomplishment of its mission which benefit is available to all similarly situated members of the same class on the same terms[.]"

- The relationship, if any, between the recipient and the nonprofit and/or its members, officers, directors, substantial contributors, or any related entities.[10]

Failure to establish appropriate criteria for recipient selection and/or to maintain the required records can have dire consequences for a nonprofit, including loss of tax-exempt status.[11]

*Reporting Financial Assistance to the IRS*

Information regarding financial assistance provided to individuals may also need to be reported on the organization's Form 990 filed with the IRS.

Depending on the location of the individual recipients and the total amount of cash assistance provided, an organization may need to complete Schedule I to Form 990 (Grants and Other Assistance to Organizations, Governments and Individuals in the United States) and/or Schedule F (Statement of Activities Outside the United States).[12]

These Schedules report grant-making and other financial assistance on an aggregate basis. Organizations are not required to include all the documentation discussed above with their filing; however, they should maintain these more detailed records for compliance purposes and in case of a later audit.

In addition, if an existing organization begins a new cash assistance program that constitutes a significant program activity for the nonprofit, it should also report the activity on Schedule O to the Form 990.

Considering Impact on Recipients

If financial assistance is being provided on the basis of need and in furtherance of an organization's charitable mission (and not in exchange for services rendered), the nonprofit organization will not need to issue Form 1099s to recipients, even if the amount of the aid exceeds $600.

In addition, the amounts received will likely not be taxable to the recipients as the Internal Revenue Code ("IRC") excludes gifts from income,[13] and the IRS has recognized that need-based payments by charities are excludible from income as gifts.[14]

Other Special Situations

*Emergency Disaster Relief*

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[10] *See* Rev. Rul. 56-304. *See also* IRS Publication 4221-PC: *Compliance Guide for 501(c)(3) Public Charities*, available at: https://www.irs.gov/pub/irs-pdf/p4221pc.pdf.

[11] *See* The Church in Boston v. Commissioner, 71 T.C. 102 (November 1, 1978) (affirming denial of tax-exempt status to a church that provided cash grants to individuals, including officers, and was not able to provide documented criteria for recipient selection, the reasons for amount given, or the purpose of each grant).

[12] Links to the various schedules for Form 990 are available at: https://www.irs.gov/forms-pubs/about-form-990-schedules.

[13] IRC Section 102(a), available at: https://www.govinfo.gov/content/pkg/USCODE-2011-title26/pdf/USCODE-2011-title26-subtitleA-chap1-subchapB-partIII-sec102.pdf.

[14] *See* Publication 3833.

The IRS has released separate guidance on providing short-term financial assistance to individuals in disaster situations, in the form of Publication 3833. The guidance allows for some of the foregoing standards to be temporarily relaxed in light of the exigent circumstances.

*Scholarship Programs*

For considerations specific to establishing and maintaining scholarship programs, see our Legal Alert: Creating a Scholarship Program.

*Employer-Sponsored Assistance Programs*

Additional rules and requirements apply to employer-sponsored assistance programs, where payments are made to a nonprofit's employees in response to a disaster or emergency hardship situation. For more information, see guidance issued by the IRS, including the EO CPE Text, or consult with an attorney.

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***This alert is meant to provide general information only, not legal advice. If you have any questions about this alert please contact Veronica Aksu at vaksu@lawyersalliance.org or visit our website at www.lawyersalliance.org for further information. To become a client, visit www.lawyersalliance.org/becoming-a-client.***

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