

Can a Nonprofit Provide Financial Support to Individuals?

Legal Issues in Nonprofit Administration of Emergency Grants and Financial Assistance

Providing aid to relieve human suffering caused by a natural disaster or an emergency hardship is charity in its most basic form. Charitable organizations are frequently able to administer relief programs more efficiently than individuals acting on their own. However nonprofit organizations with 501(c)(3) tax exempt status have an obligation to ensure their assets are used in furtherance of their charitable assets, and that those assets are not used to benefit individuals in violation of the tax code.

Below is a basic guide to the considerations a nonprofit organization should take into account when considering whether and how to grant money to directly benefit an individual without jeopardizing the charitable organization or its tax-exempt status.

Legal Considerations for Emergency Funds

1. Determine whether Distribution of Funds is within your Charitable Purpose

The Board of Directors or Executive Director should check the organization's certificate of incorporation to ensure that the planned activities fall within the organization's current corporate purposes. If not, a nonprofit in New York may need to amend its certificate, which requires Board action, New York Attorney General approval, and filing with the New York State Department of State.

2. Establish Eligibility Criteria for Fund Recipients

Nonprofits should be careful and deliberate in deciding who receives emergency funds. Generally, an organization must have a set of criteria by which it can objectively make distributions to individuals who are financially or otherwise distressed, and must collect adequate records in order to support the basis upon which assistance is provided. However, the type of information needed to support assistance may vary depending on the circumstances.

Disaster Relief Grants

A charitable organization that is distributing short-term emergency assistance may require far less documentation, in the way of victims establishing that they need relief assistance, than an organization that is distributing longer-term aid. In general, providing funds to victims of floods or other disasters would not require a showing of financial need, since the individual requiring these services is distressed irrespective of the individual's financial condition.

Identifying a Charitable Class

Particularly when fund allocation is not tied to disaster relief, nonprofit organizations must select a qualifying charitable class. In the case of cash grants, determinations should be made on the basis of financial need. Rather than benefiting a few pre-selected individuals, a proper charitable

class will be sufficiently large and indefinite such that enough that providing aid to members of the class benefits the community as a whole.

3. Observe Restrictions on Recipients of Funds

Prohibition on Identifying Grant Recipients in Advance

A donor will not be able to claim a tax deduction for a gift made directly to a needy individual or a victim of a natural disaster. Similarly, a donor will not be able to claim a deduction for a gift made to a fund established to benefit a specified individual or family, because a gift to a specified individual or family is not "charitable" within the meaning of the federal tax law.

On the other hand, if a donor makes a contribution to a nonprofit with 501(c)(3) tax exempt status with a legally compliant individual grant program, that contribution may be deductible in the same manner as other contributions to the nonprofit.

Prohibition on Private Inurement

Nonprofits must 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 creator or the creator's family, shareholders of the organization, other designated individuals, or persons controlled directly or indirectly by such private interests. Grants should not be made to members of a grant selection committee or their family members or to substantial contributors or their family members. Grants to employees of public charities are permissible, but you should consult an attorney before making such a grant.

4. Documentation of Grants to Individuals Program

Issuing Donor Acknowledgements

When a contributor makes a donation to a qualified organization, the contributor must substantiate the amount of the contribution by maintaining reliable written records, such as cancelled checks or receipts. In addition, two different types of gifts require written acknowledgements from the charitable organization: a single contribution of \$250 or more, and a *quid pro quo* single contribution in excess of \$75. A *quid pro quo* contribution is a payment made partly as a contribution and partly as a payment for goods or services.

Documenting Grants to Individuals

In most cases, a nonprofit organization will not need to issue an IRS Form 1099 to recipients of emergency funds, provided the person to whom the cash assistance is being given is a member of a charitable class entitled to assistance. That is because the payments are not being made in exchange for *services* in the course of the agencies' business.

The Internal Revenue Code excludes gifts from income, so the recipient of funds will probably not need to pay taxes on funds received. The IRS has recognized that need-based payments by charities are excludible from income as gifts. Further, the Tax Relief Act sets forth exclusions for disaster relief payments for identified disasters. The list of eligible disasters is updated regularly and can be found at <https://www.irs.gov/newsroom/tax-relief-in-disaster-situations>.

This alert is meant to provide general information only, not legal advice. Please contact Elizabeth Perez at (212) 219-1800 ext. 232 if you have any questions about this alert.

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