Unusual Grants: An Online Legal Guide for Public Charities

by Jane C. Nober*

Grantmaking is a key function of community foundations and many other public charities. Most of the grants these charities make are to other public charities, and the legal aspects of the transactions are fairly straightforward; the grantmaker ascertains that the grantee organization has been determined by the IRS to be a publicly supported charitable organization, and the grantmaker sends a check. However, when grantmakers wish to support the charitable activities of organizations that do not have an IRS determination letter that describes them as a 501(c)(3) public charity, the process can be more complicated. This resource is a guide to nine areas in which community foundations and other public charities often wish to make grants. It provides links to specific legal information and resources on grants to religious institutions, grants to government, grants to non-charitable exempt organizations, international grantmaking, fiscal sponsorships, disaster relief and emergency hardship grants, scholarships, grants to private foundations and grants from donor advised funds. After the enactment of the Pension Protection Act, new rules apply to grants from donor advised funds. For that reason, this guide is a good resource for grants from unrestricted assets and all other types of funds (e.g., field of interest funds) but those awarding grants from donor advised funds should focus on the final section devoted to resources for grantmaking from donor advised funds. As always, general legal information is no substitute for the advice of knowledgeable counsel when it comes to a specific situation confronting a grantmaker.

As a reminder, note that the general guidelines in this memo do not apply to grants made from donor advised funds. For these types of grants, please click here.

I. The Usual Grants

As charities, community foundations and other public charities must be organized and operated for charitable purposes. This means that any grants these organizations make must be for charitable purposes. When a public charity such as a community foundation wants to make a grant to another public charity, such as a local hospital or symphony orchestra, this legal requirement is easy to meet; if the proposed grantee is also a charity, it is, by definition, also organized and operated for charitable purposes. Any money that it receives must be spent on charitable activities.

A community foundation or other public charity can ascertain that a potential grantee is a public charity in a number of ways. First, grantmakers can ask for a copy of the grantee’s determination letter from the IRS. This is the letter that the IRS sends to a charity after it has reviewed the group’s application for recognition of exemption from federal income tax and decided that the entity will
indeed be organized and operated for charitable purposes. These letters generally begin, “Based on information you supplied, and assuming your operations will be as stated in your application for recognition of exemption, we have determined you are exempt from federal income tax under section 501(c) of the Internal Revenue Code as an organization described in section 501(c)(3).”

The determination letter also reveals whether the potential grantee is a public charity or a private foundation. If the organization is a public charity, the determination letter will generally state that it is (or can reasonably expect to be) a “publicly supported organization described in sections 509(a)(1) and 170(b)(1)(A)(vi).” It is less common but also possible for a determination letter to mention section 509(a)(2) or section 509(a)(3) instead of section 509(a)(1). Organizations described in both of these sections are also public charities. If the determination letter describes the charity as “a private foundation within the meaning of section 509(a) of the Code,” the organization is not a public charity but rather a private foundation. For information on grantmaking to private foundations, click here.

Under the Tax Code, if an organization has a valid determination letter stating that it is a public charity, a contributor is entitled to rely on it. That means that even if the IRS later decides that the grantee should not have been deemed a public charity when donors made gifts to it, individual donors will generally not lose the tax deductions they took for contributions and charitable organizations will generally not be held to have made a non-charitable distribution. Under most circumstances, a private foundation that makes a grant to a group that has a valid determination letter cannot be penalized if the letter is subsequently revoked.

Some potential grantees have very old determination letters; some have very new ones. Click here for more information on when you can rely on a grantee’s determination letter. This article also discusses which grants do, and which grants do not, require an extensive grant agreement and lays out some of the elements of a basic grant agreement.

Another way to check on whether a potential grantee is a public charity—or to make sure that a charity’s determination letter is still valid—is to search the IRS’s Exempt Organizations Select Check tool. It is not a perfect research tool. Some groups with valid determination letters have been mistakenly omitted. Others are listed under old or formal names that many seekers will not know to check. Finally, there can be a delay between the IRS’s revocation of tax-exempt status and the removal of an organization from the EO Select Check tool.

Another tool for checking the exempt-status – including if a potential grantee is a section 501(a)(1), 501(a)(2) or 501(a)(3) organization is to check the IRS Master Business File. While it is cumbersome to search, it can be a helpful tool if you need to get more specific information about an organization than you can find in Select Check.

Yet another tool for checking on the tax status of a potential grantee is GuideStar, an online compilation of data about charities that is the product of Philanthropic Research, Inc. GuideStar gathers its information directly from the IRS and also from the listed charities. The site contains financial data, including copies of charities’ tax returns, and information about groups’ missions and activities—all important material to look at when evaluating whether to make a particular grant.
Grantmakers should keep a record of the efforts they have made to determine whether a potential grantee is a public charity. Whether in electronic or paper form, these records should be adequate to show an inquiring IRS agent that the organization was diligent about checking the tax status of potential grantees.

II. The Unusual Grants

Now that you have gotten a sense of what to do when a potential grantee is a public charity with a valid IRS determination letter, let us turn to the situations in which the organization does not have such a document on hand.

A. Grants to Religious Institutions
Many grantmakers wish to make grants to churches, synagogues and mosques, or organizations that are closely affiliated with such religious institutions. Click here for more information on these types of grants.

Some grantmakers receive requests to fund missionaries. Click here for more on what the IRS terms “deputized fundraising.”

B. Grants to Government
Government agencies, school districts and public libraries can all be charitable grantees. Click here to learn more about the circumstances under which grants can be made to these entities.

Determining whether a particular entity is in fact a governmental entity or instrumentality can be a challenge. An IRS continuing professional education article was written to train IRS agents on how to make such determinations. Although taxpayers (including grantmakers) cannot rely on this material to defend their actions should the IRS ever question them, they can gather from it a sense of the IRS’s thinking on this subject.

C. Grants to Non-Charitable Exempt Organizations
Religious organizations and governmental entities may not have determination letters, but for most purposes they are considered the equivalent of a 501(c)(3) public charity. Non-charities are different. These are organizations that are exempt from federal income taxation under section 501(c) of the Code but derive their exemption from a section other than section 501(c)(3). Like public charities, they pay no federal income tax, but unlike charities, deductions to them do not qualify for income tax charitable deductions except under very limited circumstances. An IRS listing of the many types of non-charitable exempt organizations can be found here.

Click here for a general introduction to making grants to noncharities.

Below is additional information on specific types of commonly

The IRS website is a good source of general information on these types of organizations.
encountered groups and the kinds of charitable and non-charitable activities they often propose to sponsor:

501(c)(2) Title-holding groups. These groups often hold title to real property for fraternal organizations (exempt under 501(c)(7)) or business groups (exempt under 501(c)(6)). Community foundations and other public charities are more likely to establish supporting organizations for this purpose. A common request from groups of this type is for a contribution toward the renovation of a historic or architecturally significant structure. It might be a fraternity house, a Masonic lodge or a deteriorating downtown building, but the paramount consideration here is always whether the renovation serves a public purpose or the private interests of the members of the fraternal or business group. Will the renovated fraternity house be open on a regular basis for public tours of its architecturally significant features or will it merely serve as private housing for undergraduate members? Will the chamber of commerce make all the space in the renovated building available to local nonprofit groups or will the building serve solely as the chamber’s new headquarters? Is the organization willing to provide assurances that the historical or architectural elements of the building will be preserved?

501(c)(4) Social welfare organizations. These are organizations devoted to the betterment of the common good and the general welfare of the community. Into this category fall community groups and hobby clubs (gardening, stamp collecting, etc.), as well as some environmental groups. These groups often pursue a broad range of charitable activities but are not organized and operated exclusively for charitable purposes. For example, they may provide benefits or services to members only or may undertake more political lobbying than a 501(c)(3) organization would be allowed to do. Grants should be narrowly targeted at specific, charitable activities of such groups, and the grantmaker should gather and retain documentation that shows the money was indeed spent on charitable activities.

501(c)(5) Labor and agricultural organizations. Labor unions, councils or committees are associations of workers that are organized to protect and promote the interests of labor in connection with employment. These organizations must be organized to carry out the betterment of the conditions of workers, the improvement of the grade of their products and the development of a higher degree of efficiency in their respective occupations. Agricultural and horticultural organizations are connected with raising livestock, maintaining forests, harvesting crops or aquatic resources, cultivating useful or ornamental plants and undertaking similar pursuits. Their primary purpose must relate to techniques of production, betterment of conditions of those engaged in agriculture or horticulture, development of efficiency, or improvement of the grade of products.

501(c)(6) Business Leagues. These are chambers of commerce and trade groups. For more detailed information from the IRS on these groups, click here. In general, they are involved in promoting their members’ economic interests (a non-charitable purpose), but these organizations may also have charitable activities. For example, they may be involved in economic development activities, downtown beautification efforts or job training—all of which may qualify as charitable activities.
an activity to qualify as charitable, it will have to serve a public interest, such as assisting a needy sector of the population, and not provide economic benefits to private interests (such as the members of the group). Thus, a project to provide job training to ex-prisoners or credit counseling to individuals who otherwise might not have access to such services would likely qualify as charitable. Again, grantmakers should provide aid that is narrowly targeted to specific, charitable activities of such groups and should gather and retain documentation that shows the money was indeed spent on charitable activities.

Business leagues often approach community foundations to establish scholarship funds for their members or members’ families. Because such a fund would provide benefits to members of the group, it would not be a charitable undertaking and the community foundation should not accept it. If a business league seeks to establish a fund to assist individuals who are not members of the group, however, this may qualify as a charitable activity. For example, a group of accountants could establish a scholarship fund to provide aid to accounting students at a local community college. For more information, click here.

501(c)(7) Social clubs. These are golf clubs, downtown clubs and country clubs. For more detailed information from the IRS on these groups, click here. These groups most frequently contact a community foundation when they wish to establish scholarship funds for employees or family members of employees. Grantmakers need to be careful that the funds are not being used to provide additional compensation to employees or as an inducement to accept or continue employment with the club. Following the rules relating to corporate scholarship programs can help address this concern.

501(c)(8) and 501(c)(10) Fraternal organizations. These are fraternal organizations that operate under the lodge system and include the Elks, the Moose and the Knights of Columbus. For more information from the IRS on these groups, click here. These groups occasionally seek to establish a scholarship fund for members or members’ families. Because such a fund would provide benefits to members of the group, it would generally not be a charitable undertaking, and the community foundation should not accept it. If a fraternal organization seeks to establish a fund to assist individuals who are not members of the group, however, this may qualify as a charitable activity. For example, a Moose Lodge could establish a scholarship fund for graduates of the local high school. As long as eligibility is not limited to relatives of Moose Lodge members, this fund should be permissible. For more information, click here.

501(c)(13) Nonprofit cemeteries. Grants may support the maintenance of the cemetery as a whole or of certain historic or artistically significant portions of the property. Restoration of a war memorial or the grave site of a famous local resident might qualify as charitable purposes. For more information, click here.

501(c)(19) Veterans’ organizations. This is a slightly tricky category of non-charitable exempt organizations because some veterans’ organizations are indeed eligible to receive tax-deductible charitable contributions. If at least 90 percent of a veterans’ group’s membership consists of war veterans and the balance consists of other veterans, widows or spouses, then the organization is
What Must Private Foundations Do?

When making international grants, private foundations must take special steps to ensure that their grants count toward their annual minimum distribution requirement (often referred to as payout”) and to prevent grants from being considered taxable expenditures subject to punitive excise taxes.

eligible to receive tax-deductible contributions and may be treated as the equivalent of a 501(c)(3) public charity–i.e., as a usual grant, not an unusual one. For exemption under 501(c)(19), war veterans need make up only 75 percent of the group’s membership. Grants to 501(c)(19) groups will require the extra steps necessary for grants to exempt but non-charitable organizations. In general, grantmakers should strive to assist veterans’ groups’ charitable activities, not their social functions. Thus, a grant to build or renovate a social hall might not be charitable, but a grant to hire a counselor or social worker to work with veterans or their families would likely qualify as charitable. This will be especially true if services will be made available to non-members of the group.

Veterans’ groups may also approach a community foundation to establish a scholarship fund. If eligibility is to be limited to relatives of the group’s members, the fund will serve the interests of the group and will not be a charitable undertaking. If eligibility is opened up to relatives of all war veterans or veterans generally, regardless of membership in the group, this should be acceptable. No fund should be established to assist the members of a single family or a very small group of families. For information from the IRS on veterans’ organizations, click here. There is also an article on veterans’ organizations from IRS continuing professional education material.

D. International Grantmaking

In communities near international borders and in areas with large immigrant populations, public charities such as community foundations may receive requests to support foreign charities. As long as the grantmaker is not prohibited from making grants outside the United States, it may make international grants. Such a prohibition might be found in the organization’s certificate of incorporation, deed of trust, bylaws or guidelines. A statement that grants can only be made within a defined geographic area within the United States would generally qualify as a prohibition. If these organizational documents use words such as “primarily” or “principally” to describe how much of the organization’s grantmaking must fall within a particular geographic area, it is likely that international grants can be made.

Public charities seeking to make international grants need not follow the special rules that apply to private foundations, but they can learn a great deal from these legal requirements. If a community foundation chooses to make grants abroad, it should familiarize itself with the basics of expenditure responsibility and equivalency determination. By adopting parts of these processes, public charities do their best to ensure that their funds are spent for charitable purposes.

For more information on international grantmaking, visit the United States International Grantmaking Project website.
The Council on Foundations recommends a four-step approach for public charities making international grants. The public charity should: (1) obtain documentation on the grantee; (2) comply with government orders and legislation relating to terrorist financing; (3) enter into a specific written agreement with the grantee, documenting the grantee’s commitments; and (4) obtain a year-end accounting from the grantee for each year until the grant funds are fully expended.

- **Obtain Documentation**

Everyone involved will be most comfortable if the public charity grantor can make a reasonable judgment that the intended non-U.S. grantee is the equivalent of a Section 501(c)(3) organization. However, such a determination is not required. The grant can be made even if the intended grantee does not quite meet all the requirements for Section 501(c)(3) status. But, whether the grantee meets all the requirements or not, the more solid documentation on file about the grantee, the better. Therefore, obtain copies of the grantee’s organizational documents (translated into English) and a description (in English) of all the grantee’s activities and programs, including any proposed activities.

- **Comply with Government Orders and Legislation to Prevent Terrorist Financing**

The *Handbook on Counter-Terrorism Measures* is a good resource on what charities need to do to comply with government regulations and orders relating to terrorist financing.

- **Enter into a Specific Written Agreement Signed by the Grantee**

Click [here](#) for a sample public charity grant form. The intent of this agreement (or affidavit) is twofold. First, it commits the grantee to use the funds for strictly charitable purposes. The purposes of the grant should be made quite specific. Grants for general support should be made only when it is clear that the grantee is the equivalent of a 501(c)(3) organization and operates exclusively for charitable purposes.

Second, it commits the grantee to a number of the basic requirements inherent in section 501(c)(3), such as prohibiting the grantee from providing private benefit (inurement), influencing legislation (lobbying), affecting the outcomes of elections and transferring assets to a noncharitable entity in case of termination. Even if the documentation provided by the grantee does not clarify these important issues sufficiently, they will be covered by the written agreement.

- **Obtain Written Reports from the Grantee**

Public charities should require the non-U.S. grantee to provide a written report at the close of each of its accounting periods until the funds are expended. The report should describe the use of the funds, compliance with the terms of the grant and the progress the grantee has made in achieving the grant’s purpose. Having written reports from the grantee on file helps demonstrate to the IRS that the private foundation is taking the steps necessary to exercise the requisite discretion and control.
E. Fiscal Sponsorship
Click here for an introduction to issues relating to fiscal agency and fiscal sponsorship. This article contains references to Greg Colvin’s Fiscal Sponsorship: Six Ways to Do It Right.

F. Disaster Relief and Emergency Hardship Grants
Disaster Relief
The events of September 11 drew attention to the IRS’s rules on providing assistance to victims of disasters. Helping the needy—whether their needs arise from poverty or a natural or civic disaster—is a charitable activity. Individuals and corporations may generally take a charitable income tax deduction for contributions to charitable organizations that aid disaster victims. Foundations, including private foundations, may generally distribute funds to disaster relief charities as well. Donors may generally request that funds be spent in a particular geographical area or to provide a particular form of aid (scholarships for victims’ families, for example).

To ensure that they are organized and operated for public purposes, all foundations should take care that their disaster relief programs serve a charitable class—a group large enough that the identity of specific aid recipients will not be known to donors. Leaving the class open by including victims of future disasters among those eligible for assistance can help ensure the charitable nature of the effort.

Aid may not be solicited or donated for the benefit of one person, one family or a small group of people, no matter how needy or deserving of assistance these individuals might be. If a contribution is earmarked for a particular individual or small group, the IRS is free to disregard the existence of the charitable entity and treat the gift as having been made directly from one individual to another—a contribution for which no charitable deduction is available (earmarking is any oral or written understanding that a contribution will be routed in a particular way). Click here for a discussion of grants to pre-selected individuals.

Establishing a program of grants to individuals who are disaster victims raises a number of issues for public charities. Public charities are not required to seek advance approval of disaster relief programs from the IRS, but a number of rules should be followed in making these sorts of grants. When a charity proposes to provide financial assistance to disaster victims or their families, it must establish that they are, in fact, needy. The IRS defines a needy person as someone who lacks the basic necessities of life—food, clothing, shelter, medical help or transportation—because of poverty or temporary distress. A person may have short-term needs in one or more of these areas even if he or she has resources (such as insurance or inheritances) that will be available in the long run. Not all losses make a person needy for the purposes of a charitable grant; it would not be charitable to give a
grant to an individual to fix the roof on a vacation home. Charitable aid is available to help people obtain necessities that will re-establish their physical, mental and emotional well-being, not to replace lost income.

The IRS has provided a fair amount of guidance on disaster grantmaking. One user-friendly resource is IRS Publication 3833. Another good resource is a memo that the IRS issued after the Oklahoma City bombing in 1995. For an IRS summary of recent (post 9-11) developments, click here.

For a practical guide to disaster grantmaking prepared by the Council on Foundations in cooperation with the European Foundation Centre, click here.

**Disaster Relief with Corporate Funds**

For many years, the IRS had a positive view of corporate funds established to help employees in times of natural disasters or personal hardships. The IRS issued letter rulings approving the disaster relief programs of a number of foundations affiliated with corporations. In the 1990s, the IRS reconsidered its position and revoked these approvals. It declared that such programs provided economic benefits to the sponsoring companies by helping the companies recruit and retain workers. Because companies that sponsor private foundations are “disqualified persons” in connection with the foundations, the IRS stated, grants that benefited the companies would be taxable acts of self-dealing for the private foundations involved. Read “Disaster Relief,” an article from IRS continuing professional education material that discusses these programs.

In the wake of the September 11 attacks, Congress enacted the Victims of Terrorism Tax Relief Act. Section 104 of the act overruled the IRS’s position by providing that corporate private foundations that made distributions to victims of the September 11 and anthrax attacks would not be treated as having made a payment to a disqualified person. This meant that there was now statutory permission for company foundations to make September 11 attacks disaster payments to employees and their survivors without risking imposition of an excise tax penalty for violating the prohibition on self-dealing.

The Technical Explanation of the Act (a document containing legislative history and explanation of the statute prepared by the staff of the Joint Committee on Taxation) further directed the IRS to expand this position to employer-funded foundations in certain other disaster situations. The Technical Explanation declared that an employer-controlled private foundation could make disaster relief distributions to employees and their families as long as the awards are based on an objective determination of need by an independent selection committee, i.e., one that is made up of individuals who are not “in a position of substantial influence,” or by adequate substitute procedures. The report directed the IRS to reconsider its rulings position to ensure that employer-controlled private foundations "will have appropriate guidance, consistent with the principles outlined above, on the circumstance under which they may provide disaster assistance in connection with a qualified disaster, specifically to the employers' employees." Under those circumstances, the Technical Explanation stated, payments will not be an act of self-dealing, will further the foundation's charitable purposes, and will meet the requirements of section 4945(g) "to the extent that they apply."
addition, contributions to the foundation will be deductible, and distributions by it will be excludable from the employee’s income as gifts without regard to any other provision of the Code.

What is a Qualified Disaster?
Under the act, a qualified disaster is (1) any disaster resulting from terroristic or military action; (2) a Presidentially declared disaster; and (3) a disaster resulting from an accident involving a common carrier, such as an airplane or a train, or from any other event, if the secretary of the Treasury determines the event to have been catastrophic. The Technical Explanation leaves open the possibility that providing need-based payments in connection with other disasters “may well further charitable purposes,” but it does not require the IRS to allow employer-funded foundations to make payments for disasters that are not “qualified disasters.”

The IRS has still not issued guidance to employer-controlled private foundations on making disaster assistance payments to employees. However, in Revenue Ruling 2003-12, the IRS has issued guidance about a new section of the Tax Code that was added by the Victims of Terrorism Tax Relief Act and that in many ways undercuts the need for companies to route disaster assistance payments through their foundations. New Section 139 of the Tax Code provides that amounts received by an individual as “qualified disaster relief payments” are not includable in gross income and effectively allows employers to directly compensate employees and their survivors for personal, family and living expenses incurred in connection with a qualified disaster (note that for this purpose, the definition of qualified disaster includes only the first three categories described in the preceding paragraph). Employer payments in connection with disasters declared by appropriate federal, state or local authorities remain taxable to the extent they were before the Act’s enactment. These payments will not constitute taxable income to the employees despite their similarity to compensation and presumably will be deductible by the employer as a business expense.

What are Qualified Disaster Relief Payments?
Qualified disaster relief payments include payments made to reimburse or pay reasonable and necessary personal, family living or funeral expenses or the costs of repair or rehabilitation of a personal residence and its contents, where such expenditures are made necessary by a qualified disaster.

Even with changes in the law, corporations and corporate foundations may still wish to work with public charities such as community foundations to administer disaster relief funds for employees. Corporations may believe they will generate more goodwill with less administrative headache by working with a community foundation.

Should community foundations accept these funds? The Technical Explanation sets out Congress’s belief that making qualified disaster relief payments to corporate employees is a charitable activity. If a private foundation sponsored by the corporation may undertake such a project, then it seems highly likely that an unrelated public charity may do so. The IRS’s guidance to corporate private foundations will be the best source of information on how these funds should operate. Until this is released, community foundations should look to the standards set out in the Victims of Terrorism Tax Relief Act and the Technical Explanation:
• Assistance should be provided based on an objective determination of need.
• Determinations should be made by an independent selection committee.
• Assistance should be limited to qualified disaster relief payments.

Emergency Hardship Assistance
Although the Victims of Terrorism Tax Relief Act of 2001, the accompanying Technical Explanation and Rev. Rul. 2003-13 expand corporations’ ability to aid employees in times of natural or civil disasters, they do not alter the IRS’s position on employer-sponsored emergency hardship funds. These funds, which may be established to help employees who have been the victims of crime or a personal loss—a fire, or a sudden death in the family—are likely to be evaluated under the requirements described in “Disaster Relief.” They might be considered recruitment or retention devices for the sponsoring corporation, and distributions from them could be deemed acts of self-dealing or non-charitable, taxable expenditures. “Disaster Relief” raises the possibility that public charities might be able to administer hardship assistance funds for an employer but only under certain narrow conditions.

In view of the IRS’s negative stance on employer-sponsored emergency hardship funds that specifically target corporate employees, community foundations that operate or contemplate operating funds of this nature should work closely with their counsel.

The most conservative position would be to avoid all employer-provided emergency hardship funds that make payments only to corporate employees. The community foundation adopting this position would only permit funds to be established that benefit the community generally and provide corporate employees with no special advantage in application or selection. The corporation could publicize its contribution to the community foundation and encourage its employees to apply for funds, but it should not convey the impression that employees will receive special treatment.

A more aggressive position would be for a corporation to establish a hardship assistance program at a community foundation and strive to meet all of the applicable conditions for public charities set out in pages 239 to 240 of “Disaster Relief.” Careful attention to the entire list of conditions is essential, but among the relevant restrictions are the following:

• The employer cannot control the fund excessively.
• The fund cannot meet the employer’s legal obligations under any employment or collective bargaining agreement.
• The beneficiaries of the fund must constitute a charitable class that is either indefinite or of sufficient size.
• An individual’s employment with the company cannot be relevant except as an initial qualifier; the individual’s employment status cannot affect the amount or type of aid provided.
• The fund must be administered by a committee that either has no relationship to the employer or is a group of employees that is a broad cross section of the work force that understands that they are acting as individuals, not as representatives of the employer.
• The fund must have specific written eligibility criteria that are objective and nondiscriminatory.
• The employer may not use the fund to recruit new employees or retain existing ones.
• The charity must inform all employees of the existence of the fund and their eligibility for relief.

G. Scholarships
Click here for a general introduction to scholarship programs for public charities such as community foundations.

H. Grants to Private Foundations
Private foundations are charities and are exempt from tax under section 501(c)(3) of the Internal Revenue Code. However, they generally receive all of their financial support from a single individual, family or company. They are subject to stricter rules governing their activities and investments than are public charities such as community foundations. For this reason, it is uncommon for community foundations and other public charities to make grants to private non-operating foundations and, in some cases, such grants are inadvisable.

One problem is that donors receive more generous tax deductions when they make gifts to community foundations rather than to most private foundations (e.g., higher maximum deductibility limit; fair market value deduction for gift public charity could be in the position of helping the donor commit tax fraud if it laundered a gift through the community foundation or public charity in order to take advantage of these more generous deductions.

In addition, community foundations certainly should not agree (even tacitly) to make such a transfer to a private non-operating foundation as a condition of establishing a donor advised fund. There is at least one private letter ruling in which the IRS determined that such a transfer would result in the donor advised fund being treated as a private foundation from its inception, and thus subject to the two-percent excise tax, applicable penalties for failing to pay same, and all other restrictions that apply to private foundations.

Grants to private operating foundations are generally permissible. These are organizations that have a narrow base of support (in some cases a large endowment) but are actively engaged in a charitable activity, such as operating a museum or nursing home.

I. Grants from Donor Advised Funds
Donor advised funds reside within and are owned by public charities and as such, most grants from donor advised funds can be made safely and don’t require any action on the part of the charity other than documenting the charitable nature of the expenditure. A specific definition of donor advised funds may be found here. However, there are certain types of grants from donor advised funds that require the charity to exercise expenditure responsibility while other types are outright prohibited. Expenditure responsibility is a type of required due diligence and documentation process to ensure funds are used for charitable purposes.
Prohibited distributions from donor advised funds include:

- Grants to individuals (including scholarships and reimbursements to individuals for expenses incurred on behalf of the fund)
- Grants to donors, advisors or related parties to the fund (Note that this applies even if the donor is an entity such as a corporation.)
- Grants for noncharitable purposes

Distributions from donor advised funds that require expenditure responsibility:

- Grants to organizations not described in section 170(b)(1)(A) – notably non-charities (including those discussed in Section C above) and private non-operating foundations. See section H above for the reasons why grants should still not generally be made from an advised fund to a private non-operating foundation. Gifts to private foundations from advised funds could be construed as excessive donor control that could cause recategorization of the advised fund to a private foundation. They could also be construed as circumventing the deduction limits that would otherwise apply to gifts to private foundations.
- Grants to type III supporting organizations that are not “functionally integrated” (Read this article about determining what type a supporting organization is).
- Grants to supporting organizations (even a “functionally integrated” type III) if the organizations that are being supported are controlled by either the donor, an advisor appointed by the donor or a related party.

If expenditure responsibility is not followed with these grants, they are subject to taxation as are grants from donor advised funds that are prohibited. Click here for more information on taxable disbursements from donor advised funds and related questions that may arise. Also read this article on determining grantee status and flowchart indicating when exercising expenditure responsibility is required.

**Conclusion**

Even if a potential grantee does not have a determination letter stating that it is a 501(c)(3) organization, it may still be engaged in charitable work worthy of community foundation support. This guide should provide assistance to grantmaking staff who want to expand the universe of organizations and programs they support. As always, we encourage you to contact the Council on Foundations Legal staff at legal@cof.org with additional questions or suggestions.

*Jane C. Nober is former special counsel at the Council on Foundations
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