

disaster *relief*



Providing assistance through
charitable organizations

INTERNAL REVENUE SERVICE
TAX EXEMPT AND GOVERNMENT ENTITIES
Exempt Organizations

disaster relief

Providing assistance through
charitable organizations

... is for people interested in providing assistance to victims of disasters or those in emergency hardship situations through tax-exempt charities. Charitable organizations have traditionally been involved in providing assistance to victims of disasters such as floods, fires, riots, storms, or similar large-scale events. Charities also play an important role in helping those in need because of a sudden illness, death, accident, violent crime, or other emergency hardship. This publication includes:

- advice about helping to provide relief through an existing charitable organization
- information about establishing a new charitable organization
- guidance about how charitable organizations can help victims
- documentation and reporting requirements
- information about the *Victims of Terrorism Tax Relief Act of 2001*
- guidance about employer-sponsored assistance programs
- information about tax treatment of disaster relief payments
- information about gifts and charitable contribution rules
- reference materials and taxpayer assistance resources



BY USING THIS PUBLICATION AS YOU BEGIN TO PLAN YOUR RELIEF EFFORTS, you will be able to ensure that your program will provide assistance to victims in ways that are consistent with the federal tax rules that apply to charities.

PROVIDING AID TO RELIEVE HUMAN SUFFERING caused by a natural or civil disaster or an emergency hardship is charity in its most basic form. Charitable organizations, including churches, are frequently able to administer relief programs more efficiently than individuals acting on their own. Charitable organizations can continue to offer assistance over long periods of time. Even if the charity later dissolves, its remaining assets are permanently dedicated to accomplishing charitable purposes and cannot be divided among the organization's members, directors, or employees.

OF COURSE, THERE ARE TAX ADVANTAGES WHEN RELIEF IS PROVIDED by a charitable organization that is tax-exempt. If an organization is exempt from federal income tax, more of its resources may be used to further its mission. Contributors to qualified charitable organizations may be eligible to claim tax deductions for their donations, and the value of these contributions is not subject to gift tax, regardless of the amount. Also, individuals receiving assistance are not generally subject to federal tax on the value of assistance they may receive from a charity to meet their personal needs.

Helping Through an Existing Charitable Organization

When a tragic event occurs there is often an overwhelming desire on the part of the community to come to the aid of the victims. In the immediate aftermath of a disaster or emergency situation, those who wish to provide help may overlook existing charities and spend precious time and resources establishing a new charitable organization and applying for tax-exempt status.

As an alternative, it may be more practical to combine resources with those of an existing charity to provide immediate relief or see whether an existing charity operating in a related area may be interested in establishing a special program to address a particular disaster or emergency hardship situation. For instance, a community fund like the United Way, a religious organization like the Salvation Army, or a relief organization like the Red Cross are all existing organizations which have provided targeted disaster relief and emergency hardship assistance in response to natural and civil disasters and other unforeseen emergencies. Community-based organizations and charities with a local presence often know best what assistance is needed and understand the social and cultural context of a disaster. Working with and supporting these existing organizations may prove to be a more efficient use of disaster relief resources.

Furthermore, even if a charity was not specifically organized to provide disaster relief and such activities were not specified in its application for exemption, an existing recognized charity may engage in disaster relief activities without obtaining prior permission from the IRS. However, it must report this new activity on its annual return and may wish to report a change in its activities to the IRS Exempt Organizations Determinations Office.

FEDERAL TAX LAW—Under Federal law, an existing qualified charity generally must be given full control and authority over the use of donated funds, and contributors may not earmark funds for the benefit of a particular individual or family. Contributions to qualified charities may, however, be earmarked for flood relief, hurricane relief, or other disaster relief.

STATE LAW CONSIDERATIONS—Some contributors are reluctant to contribute to an existing umbrella organization with many programs. They are concerned that their donations will not be spent directly to serve the victims of the particular emergency they wish to help, and instead, will be applied to other organizational expenses. To address these concerns, many states and local authorities that

regulate charitable solicitation rules have imposed regulations that provide that, if a charity represents that funds will be used for the relief of the victims of a particular disaster, the funds may not be used for other programs of the organization. Charitable organizations and contributors should be aware of the solicitation rules that may apply in their particular jurisdiction.

Establishing a New Charitable Organization

When no existing charity appears to have the capability to carry out an effective disaster relief or emergency hardship program, or when the potential organizers of the charity have long-term goals extending beyond the immediate crisis situation, it may be appropriate to consider establishing a new charitable organization. An organization qualifies as an exempt charitable organization if it is organized and operated exclusively for charitable purposes, serves public rather than private interests, and refrains from participating or intervening in any political campaign or engaging in substantial amounts of lobbying activity.

APPLYING FOR TAX-EXEMPT STATUS—Generally, a new charitable organization with actual or anticipated annual gross receipts in excess of \$5,000 must submit an application for exemption and be recognized as tax-exempt by the IRS. There are exceptions to this general rule. Churches, synagogues, temples, and mosques may, but are not required to, apply for tax-exempt status from the IRS.

You may wish to consult the IRS website at www.irs.gov/eo, and review the following IRS resources when establishing a charitable organization:

Life Cycle of a Public Charity/Private Foundation

These life cycles, which can be accessed at www.irs.gov/eo contain links to helpful information about points of intersection between disaster relief organizations and the IRS, including access to explanatory information and forms that organizations may need to file with the IRS.

Publication 4220, *Applying for 501(c)(3) Tax-Exempt Status*

Provides information about eligibility for section 501(c)(3) status, how to apply for tax-exempt status and the responsibilities of section 501(c)(3) organizations.

Form 1023, *Application for Recognition of Exemption from Federal Income Tax Under Section 501(c)(3) of the Internal Revenue Code*

Applicants for tax exempt status under section 501(c)(3) generally must file Form 1023.

Publication 557, *Tax-Exempt Status for Your Organization*

Provides basic requirements to qualify as a tax-exempt charitable organization, and describes the application process.

EMPLOYEE IDENTIFICATION NUMBER (EIN)—An organization must obtain an employer identification number before it applies for tax-exempt status. An EIN is an organization’s account number with the IRS. It should be used on all correspondence with the IRS and must be entered on application forms as well as annual information and tax returns.

You can apply for an EIN:

- ▶ Online by clicking on the Employer ID Numbers link at www.irs.gov/businesses. The EIN is issued immediately once the application information is validated (Certain organizations, including those with a foreign address and certain LLCs may not file online.) This is the preferred application method.
- ▶ By telephone at (800) 829-4933 (a toll free number). International applicants must call (215) 516-6999 (not a toll free number). An assistor will provide the number to an authorized party by phone.
- ▶ By Faxing or mailing a completed Form SS-4, *Application for Employer Identification Number*, to the FAX numbers or address specified in the form instructions. The form and instructions are available on www.irs.gov or by calling (800) 829-3676.

If you have already applied for an EIN and have not yet received it, or you are not sure whether you have an EIN, call our toll-free customer account services number, (877) 829-5500 for assistance.

EXPEDITED PROCESSING OF APPLICATIONS FOR EXEMPTION—Normally, a Form 1023, *Application for Recognition of Exemption under section 501(c)(3) of the Code*, is processed in order based upon the date it is received; however, a new disaster relief or emergency hardship organization may request expedited handling of its application. An organization should only request expedited handling of its application if there is a compelling reason for the IRS to approve such a

request. An application will not be expedited simply because the organization may serve disaster victims. The organization must demonstrate 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. Requests for expedited handling are infrequently approved, and even if consideration of the application is expedited, there is no guarantee that tax-exempt status will be granted.

The request for expedited processing should accompany the application and user fee, and should include:

- a compelling reason to process the application ahead of others;
- a brief description of the disaster and details of how the organization will provide relief;
- an explanation of the immediate need for the specific disaster relief services the organization provides;
- a description of any pending grants, including information about the grantor and the amount or property to be received;
- an explanation of how the loss of the grant(s) might impact the organization's ability to operate and provide relief;
- 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;
- a statement explaining any other anticipated consequences should the expedited processing be denied; and the
- date an exemption letter is required, if applicable.

The following examples demonstrate the types of situations in which a request for the expeditious handling of an application for exemption would be appropriate or inappropriate.

EXAMPLE 1: An organization has a matching grant pending that would double the funds it has available to provide immediate counseling for children directly affected by an earthquake. The organization can only

receive the funds if it can prove that it is exempt under section 501(c)(3). Expediting the processing of the application under these circumstances is appropriate because the organization would otherwise lose this significant grant money that is to be used to provide counseling to children at a time when they most need it.

EXAMPLE 2: An organization plans to raise funds to be used to erect a monument to victims of a plane crash. Certain businesses and members of the general public have expressed interest in contributing to the project, however, there are no firm commitments for funding. While the organization intends to honor disaster victims, it is not providing disaster relief. Furthermore, there is no evidence that there are any significant grants pending or any other business reason to expedite consideration of the application. Expedited treatment of the application would not be appropriate.



PUBLIC CHARITY VS. PRIVATE FOUNDATION—Every exempt charitable organization is classified as either a public charity or a private foundation. Generally, organizations that are classified as public charities are those that:

- are churches, hospitals, schools, and qualified medical research organizations affiliated with hospitals, schools, colleges and universities;
- have an active fundraising program and normally receive a substantial part of their support in the form of contributions from publicly supported organizations, governmental units, and/or from the general public;
- normally receive not more than one-third of their support from gross investment income and unrelated business taxable income over the tax imposed on that income and more than one-third of their support from contributions, membership fees, and gross receipts from activities related to their exempt functions; and
- support other public charities.

Because public charities typically solicit funds from the general public and are generally subject to more public scrutiny and oversight in their daily operations, they are less restricted in the type of disaster assistance and emergency hardship relief they may provide than private foundations. See **Employer-Sponsored Assistance Programs** below.

Private foundations, in contrast, typically have a single major source of funding (usually gifts from one family or corporation), rather than funding from many sources. Many have as their primary activity the making of grants to other charitable organizations and individuals, rather than the direct operation of a charitable program.

Classification as a public charity or private foundation is important because different tax rules apply to the operations of each. Deductibility of contributions to a private foundation is more limited than deductibility of contributions to a public charity. In addition, private foundations are subject to excise taxes, including taxes on acts of self-dealing. For example, it is self-dealing if the income or assets of a private foundation are used by or for the benefit of a substantial contributor to the foundation or a person in control of the foundation, and the benefit is not incidental or tenuous.

Publication 557, *Tax-Exempt Status for your Organization*, explains some of the distinctions between public charities and private foundations. See also the *Life Cycle of a Public Charity* and the *Life Cycle of a Private Foundation* at www.irs.gov/eo.

How Charitable Organizations Help Victims

Charitable organizations can serve disaster victims and those facing emergency hardship situations in a variety of ways.

AID TO INDIVIDUALS—Organizations may provide assistance in the form of funds, services, or goods to ensure that victims have the basic necessities, such as food, clothing, housing (including repairs), transportation, and medical assistance (including psychological counseling). The type of aid that is appropriate depends on the individual's needs and resources. Disaster relief organizations are generally in the best position to determine the type of assistance that is appropriate.

For example, immediately following a devastating flood, a family may be in need of food, clothing, and shelter, regardless of their financial resources. However, they may not require long-term assistance if they have adequate financial resources. Individuals who are financially needy or otherwise distressed are appropriate recipients of charity. Financial need and/or distress may arise through a variety of circumstances. Examples include individuals who are:

- ▶ temporarily in need of food or shelter when stranded, injured, or lost because of a disaster
- ▶ temporarily unable to be self-sufficient as a result of a sudden and severe personal or family crisis, such as victims of violent crimes or physical abuse
- ▶ in need of long-term assistance with housing, childcare, or educational expenses because of a disaster
- ▶ in need of counseling because of trauma experienced as a result of a disaster or a violent crime

AID TO BUSINESSES—Disaster assistance may also be provided to businesses to achieve the following charitable purposes:

- ▶ to aid individual business owners who are financially needy or otherwise distressed

- to combat community deterioration
- to lessen the burdens of government

An exempt charity can accomplish a charitable purpose by providing disaster assistance to a business if:

- the assistance is a reasonable means of accomplishing a charitable purpose; and
- any benefit to a private interest is incidental to the accomplishment of a charitable purpose

Once a damaged business has been restored to viability or a newly attracted business is self-supporting, further assistance from a charity is no longer appropriate. Charities that aid businesses should have criteria and procedures in place to determine when aid should be discontinued.

EXAMPLE: As a result of a tornado, the central business district of a community is severely damaged. Because of the devastation, the area has become blighted. No single business wants to begin restoration efforts until it can be assured that the whole business district will be restored. A charity may provide funds to begin rebuilding the infrastructure of the district, such as for roads, sidewalks, parks, sewers, and power lines. This type of assistance would accomplish a charitable purpose by combating community deterioration. Any benefit to the business is incidental to the public purpose accomplished by the charity's program of assistance to the community.

CHARITABLE CLASS—The group of individuals that may properly receive assistance from a tax-exempt charitable organization is called a “charitable class.”

A charitable class must be large enough or sufficiently indefinite that the community as a whole, rather than a pre-selected group of people, benefits when a charity provides assistance. For example, a charitable class could consist of all the individuals in a city, county or state. This charitable class is large enough that the potential beneficiaries cannot be individually identified and providing benefits to this group would benefit the entire community.

If the group of eligible beneficiaries is limited to a smaller group, such as the employees of a particular employer, the group of persons eligible for assistance

must be indefinite. To be considered to benefit an indefinite class, the proposed relief program must be open-ended and include employees affected by the current disaster and those who may be affected by a future disaster. Accordingly, if a charity follows a policy of assisting employees who are victims of all disasters, present or future, it would be providing assistance to an indefinite charitable class. If the facts and circumstances indicate that a newly established disaster relief program is intended to benefit only victims of a current disaster without any intention to provide for victims of future disasters, the organization would not be considered to be benefiting a charitable class.

Because of the requirement that exempt organizations must serve a charitable class, a tax-exempt disaster relief or emergency hardship organization cannot target and limit its assistance to specific individuals, such as a few persons injured in a particular fire. Similarly, donors cannot earmark contributions to a charitable organization for a particular individual or family.

EXAMPLE 1: Linda's baby, Todd, suffers severe burns in a fire requiring costly treatment that Linda cannot afford. Linda's friends and co-workers form the Todd Foundation to raise funds from fellow workers, family members, and the general public to meet Todd's expenses. Since the organization is formed to assist a **particular individual**, it **would not qualify** as a charitable organization.

Consider this alternative case: Linda's friends and co-workers form an organization to raise funds to meet the expenses of an open-ended group consisting of all children in the community injured by disasters where financial help is needed. Neither Linda nor members of Linda's family control the charitable organization. The organization controls the selection of aid recipients and determines whether any assistance should be provided to Todd. Potential donors are advised that, while funds may be used to assist Todd, their contributions might well be used for other children who have similar needs. The organization does not accept contributions specifically earmarked for Todd or any other individual. The organization, formed and operated to assist an **indefinite** number of current and future disaster victims, **qualifies** as a charitable organization.

See the example in the section on **Gifts and Charitable Contribution Rules** for a situation where providing disaster assistance apart from a qualified charity is desirable.

EXAMPLE 2: A hurricane causes widespread damage to property and loss of life in several counties of a coastal state. Over 100,000 homes are damaged or destroyed by high winds and flooding. The **group of people affected by the disaster is large enough** so that providing aid to this group benefits the public as a whole. Therefore, a charitable organization can be formed to assist persons in this group since the eligible recipients comprise a charitable class.

EXAMPLE 3: A hurricane causes widespread damage to property and loss of life in several counties of a coastal state. In one of the affected counties, an existing charitable organization has an ongoing program that provides emergency assistance to residents of the county. A small number of residents of this county suffered significant injury or property damage as a result of the storm. The organization provided assistance to some of these individuals. The organization's assistance was provided to a charitable class because **the group of potential recipients is indefinite** in that it is open-ended to include other victims of future disasters in the county.

NEEDY OR DISTRESSED TEST—Generally, a disaster relief or emergency hardship organization must make a specific assessment that a recipient of aid is financially or otherwise in need. Individuals do not have to be totally destitute to be financially needy; they may merely lack the resources to obtain basic necessities. Under established rules, charitable funds cannot be distributed to individuals merely because they are victims of a disaster. Therefore, an organization's decision about how its funds will be distributed must be based on an objective evaluation of the victims' needs at the time the grant is made. The scope of the assessment required to support the need for assistance may vary depending upon the circumstances.

A charity may provide crisis counseling, rescue services, or emergency aid such as blankets or hot meals in the immediate aftermath of a disaster without a showing of financial need. Providing such services to the distressed in the immediate aftermath of a disaster serves a charitable purpose regardless of the financial condition of the recipients. However, as time goes on and people are able to call upon their individual resources, it may become increasingly appropriate for charities to conduct individual financial needs assessments. For example, if a charity intends to provide three to six months of financial assistance to families to pay for basic housing because of a disaster or emergency hardship, it would be required to make an assessment of financial need before disbursing aid. While

those who may not have the resources to meet basic living needs may be entitled to such assistance, those who do not need continued assistance should not use charitable resources.

NO AUTOMATIC RIGHT TO CHARITY AID—An individual who is eligible for assistance because the individual is a victim of a disaster or emergency hardship has no automatic right to a charity’s funds. For example, a charitable organization that provides disaster or emergency hardship relief does not have to make an individual whole, such as by rebuilding the individual’s uninsured home destroyed by a flood, or replacing an individual’s income after the person becomes unemployed as the result of a civil disturbance. This issue is especially relevant when the volume of contributions received in response to appeals exceeds the immediate needs. A charitable organization is responsible for taking into account the charitable purposes for which it was formed, the public benefit of its activities, and the specific needs and resources of each victim when using its discretion to distribute its funds.

SHORT-TERM AND LONG-TERM ASSISTANCE—Often charitable organizations (or programs of existing charities) are established as a result of a particular disaster where both short-term and long-term assistance might be required. The following types of assistance, if based on individual need, would be consistent with charitable purposes:

- assistance to allow a surviving spouse with young children to remain at home with the children to maintain the psychological well-being of the family
- assistance with elementary and secondary school tuition and higher education costs to permit a child to attend school
- assistance with rent, mortgage payments or car loans to prevent loss of a primary home or transportation that would cause additional trauma to families already suffering
- travel costs for family members to attend funerals and to provide comfort to survivors.

EXAMPLE: A group of individuals are killed in a fire in a large office complex. A charitable organization was previously formed to assist needy individuals in the surrounding region. The charity determines that some victims’ spouses and dependents lack adequate resources to meet immediate basic needs; others have resources to meet these needs, but will likely have a continuing need for counseling, medical, housing, childcare, and education expenses. In this circumstance, the organization

can grant funds to assist in meeting current and continuing needs. The organization can also set aside funds for possible future needs. However, when payments are made out of the set-aside funds, they must be based on needs of victims' families that exist at the time the payments are made.

Documentation

An organization must maintain adequate records to show that the organization's payments further the organization's charitable purposes and that the victims served are needy or distressed. Charities must also maintain appropriate records to show that they have made distributions to individuals after making appropriate needs assessments based on the recipients' financial resources and their physical, mental and emotional well-being. (See the *Victims of Terrorism Tax Relief Act of 2001* below for a modification to the documentation requirements.)

Generally, documentation should include:

- a complete description of the assistance provided
- costs associated with providing the assistance
- the purpose for which the aid was given
- the charity's objective criteria for disbursing assistance under each program
- how the recipients were selected
- the name, address, and amount distributed to each recipient
- any relationship between a recipient and officers, directors or key employees of or substantial contributors to the charitable organization
- the composition of the selection committee approving the assistance

DOCUMENTATION OF SHORT-TERM EMERGENCY AID—A charitable organization that is distributing short-term emergency assistance would only be expected to maintain records showing the type of assistance provided, criteria for disbursing assistance, date, place, estimated number of victims assisted (individual names and addresses are not required), charitable purpose intended to be accomplished, and the cost of the aid. Examples of such short-term emergency aid would include the distribution of blankets, hot meals, electric fans, or coats, hats, and gloves. An organization that is distributing longer-term aid should keep the more-detailed type of records described above.

Reporting

Most public charities and all private foundations are required to file an annual information return. Public charities file Form 990, *Return of Organization Exempt from Income Tax*, Form 990-EZ, *Short Form Return of Organization Exempt from Income Tax*, or Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required To File Form 990 or 990-PF*. Private foundations file Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*.

If a public charity carries on disaster relief activities as one of its three largest programs, it must describe the services provided in the Statement of Program Service Accomplishments on Form 990 or Form 990-EZ. See the form instructions for additional information about reporting obligations of public charities with respect to grants or other types of disbursements to individuals in connection with disaster relief programs. A public charity also may be required to complete Schedule F if it carries out foreign operations or Schedule I for grants or other assistance to individuals.

Similarly, if a private foundation carries on disaster relief activities as one of its four largest programs, it must describe the services provided in its summary of direct charitable activities on Form 990-PF. See the Form 990-PF instructions for further information about reporting disaster relief activities of private foundations such as grants or other types of disbursements to individuals.

For additional information about the reporting requirements of public charities and private foundations, see the *Life Cycle of a Public Charity* and the *Life Cycle of a Private Foundation* at www.irs.gov/eo, as well as Publication 4221-PC, *Compliance Guide for 501(c)(3) Public Charities* and Publication 4221-PF, *Compliance Guide for 501(c)(3) Private Foundations*.

Victims of Terrorism Tax Relief Act of 2001

The *Victims of Terrorism Tax Relief Act of 2001* (the “Act”) enacted on January 23, 2002 as P.L. 107-134, made significant changes in the rules regarding the tax treatment of distributions made by charities, including employer-sponsored charities, corporations, and others for disaster relief purposes. While the special statutory rule put in effect by section 104 of the Act and described below applies exclusively to the provision of disaster relief to victims of the September 11 terrorist



attacks and subsequent illnesses and deaths from anthrax inhalation, section 139 of the Internal Revenue Code (as added by the Act) is applicable to the tax treatment of disaster relief provided in many qualified disaster situations and is important to charities, donors, and others involved in the conduct of disaster relief programs.

The Technical Explanation of the Act indicates that, in light of the severity of the distress arising out of the attacks and the varied needs of the victims, a charity could pay a wide array of expenses and still be operating exclusively for exempt purposes. Through the Act, Congress made clear that, in appropriate situations, charities may provide more broad-based assistance and address the psychological needs, as well as the economic needs, of the victims. For example, payments to permit a surviving spouse to stay home with young children, tuition assistance to permit a child to remain in the same educational environment, mortgage payment assistance, and assistance with car loans to forestall losses that would cause additional trauma to grieving families, were permitted under the Act in the aftermath of the September 11 attacks. The Technical Explanation indicated that other types of assistance, that the scope of the tragedy made it difficult to anticipate, could also serve a charitable purpose. Accordingly, it was intended that the type of assistance that a charity may provide in disaster situations should be liberally construed.

APPLICATION OF THE SPECIAL STATUTORY RULE—As noted earlier, charities providing disaster relief assistance are generally required to make an assessment of a disaster victim’s economic need except in the immediate aftermath of a disaster. In order to make it easier for charities and employers to quickly provide relief to the victims of the terrorist attacks on the United States of September 11, 2001, and the subsequent attacks involving anthrax, Congress made several modifications to the rules governing the tax treatment of distributions by charitable organizations to individuals and businesses for disaster relief purposes.

Section 104 of the Act provided that charitable organizations making payments to victims of the September 11 terrorist attacks and those who became ill or died from anthrax inhalation could make disbursements without the charity making a specific assessment of need. The special rule applies **provided that the organization makes the payments in good faith using any reasonable and objective formula which is consistently applied**. While the Act broadened the way in which charities providing September 11 relief could determine need, it did not change the requirements that payments must serve a charitable class that is large and/or indefinite in size and may not confer a private benefit.

In applying the special statutory rule, the IRS interprets:

- **good faith** to mean that the charity is applying its best efforts to accomplish its charitable purpose; and
- **a reasonable and objective formula that is consistently applied** to mean that the charity is using objective distribution criteria that take into account all pertinent circumstances, including the size of the distributions, to avoid impermissible private benefit.

Disaster relief payments made under the special rule are treated as payments related to the organization’s exempt purposes. Of course, charities still have the option to make the traditional assessment of need. Organizations are not required to use the special rule.

The special rule applies to both public charities and private foundations, and permits employer-sponsored private foundations to make such distributions to affected company employees. Under the special rule, a private foundation could make payments to employees and their survivors without liability for excise taxes for self-dealing. Instead, private foundations could use the relaxed assessment of need available to other charities.

INCOME TAX TREATMENT OF QUALIFIED DISASTER PAYMENTS—*The*

Victims of Terrorism Tax Relief Act of 2001 also added section 139 to the Internal Revenue Code, effective for taxable years ending on or after September 11, 2001. Section 139 provides that **qualifying disaster payments** from any source, including employers, reimbursing or paying individuals' specified expenses in connection with **qualified disasters** are not taxable as income and are not subject to employment taxes or withholding.

A qualified disaster is defined in section 139 as a disaster that:

- results from terrorist or military actions
- results from an accident involving a common carrier
- is a Presidentially declared disaster
- is an event that the Secretary of the Treasury determines is catastrophic

Qualified disaster relief payments within the meaning of section 139 include payments received (regardless of the source) for the following expenses:

- reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster
- reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence due to a qualified disaster (a personal residence can be a rented residence or one you own) and
- reasonable and necessary expenses incurred for the repair or replacement of the contents of a personal residence due to a qualified declared disaster

Payments by a federal, state, or local government or their agencies or instrumentalities to persons affected by a qualified disaster in order to promote general welfare are also considered to be qualified disaster relief payments. For purposes of such payments by federal, state, or local governments, a qualified disaster includes the events listed above, as well as a disaster determined by a federal, state, or local authority to warrant governmental assistance.

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 of lost wages, lost business income, or unemployment compensation

Employer-Sponsored Assistance Programs

Frequently, employers fund relief programs through charitable organizations aimed at helping their employees cope with the consequences of a disaster or personal hardship. As noted above, all charitable organizations, including those that provide disaster relief, must demonstrate that they serve a public rather than a private interest and serve a charitable class. In the past, employer-sponsored organizations were considered to enhance employee recruitment and retention, resulting in private benefit to sponsoring employers. In addition, there were concerns that employers could exercise undue influence over the selection of recipients. For these reasons, special rules apply to employer-sponsored charities. Employer-sponsored charities sometimes establish emergency hardship funds to help employees who have been the victims of crime or a personal loss such as a fire or a sudden death in the family.

Not all employer-sponsored charitable organizations are permitted to provide assistance to employees and their families in any type of emergency hardship situations. The types of benefits a charitable organization can provide through an employer-sponsored assistance program depend on whether the employer-sponsored organization is a public charity, a donor advised fund, or a private foundation. When an employer-sponsored organization provides assistance to employees, certain limitations apply that help to ensure that such aid does not result in impermissible private benefit to the employer.

EMPLOYER-SPONSORED PUBLIC CHARITIES— Because public charities typically receive broad financial support from the general public, their operations are generally more transparent and are subject to greater public scrutiny. Accordingly, public charities may provide a broader range of assistance to employees than can be provided by donor advised funds or private foundations. Public charities can establish employer-sponsored assistance programs to respond to any type of disaster or employee emergency hardship situations, as long as the related employer does not exercise excessive control over the organization.

To ensure the program is not impermissibly serving the related employer, the following requirements must be met:

- the class of beneficiaries must be large or indefinite (a “charitable class”),
- the recipients must be selected based on an objective determination of need or distress, and

- ▶ 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. The charity'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.

If these requirements are met, the public charity's payments to the employer-sponsor's employees and their family members in response to a disaster or emergency hardship are presumed: (1) to be made for charitable purposes and (2) not to result in taxable compensation to the employees.

EMPLOYER-SPONSORED DONOR ADVISED FUNDS—Certain community foundations and other public charities maintain separate funds or accounts to receive contributions from individual donors, and the donor receives advisory privileges over investment or distribution of the donated funds.

In general, these organizations, known as donor advised funds, can make grants to 501(c)(3) public charities and, under certain conditions, to other organizations for charitable purposes, but cannot make grants to individual persons. However, there is an exception for certain employer-related funds or accounts established to benefit employees and their family members who are victims of a **qualified disaster**.

A donor advised fund or account can make grants to employees and their family members in the following circumstances:

- ▶ the fund serves the single identified purpose of providing relief from one or more **qualified disasters** as defined above in the discussion of the *Victims of Terrorism Tax Relief Act of 2001*
- ▶ the fund serves a charitable class,
- ▶ recipients of grants are selected based upon an objective determination of need,
- ▶ 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),

- 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 selection committee, and
- the fund maintains adequate records to demonstrate the recipients need for the disaster assistance provided.

For a description of the types of records a fund must retain, see the previous section **Documentation**.

EMPLOYER-SPONSORED PRIVATE FOUNDATIONS—Like public charities, private foundations can make need-based distributions to victims of disasters or to the poor or distressed. However, several issues arise when an employer-sponsored private foundation provides aid that favors the employees of the sponsoring employer. The IRS has previously ruled that, because the availability of the disaster relief programs aided employers in recruiting and retaining a stable workforce, such programs conferred a significant private benefit on the sponsoring companies. However, after the September 11 attacks, Congress took the position that employer-sponsored private foundations should be able to provide assistance to employees in certain situations.

Accordingly, employer-sponsored private foundations may provide assistance to employees or family members affected by a **qualified disaster**, as defined in Section 139 of the Code and above in the ***Victims of Terrorism Tax Relief Act of 2001***, as long as certain safeguards are in place to ensure that such assistance is serving charitable purposes, rather than the business purposes of the employer. Employer-sponsored private foundations can only make payments to employees or their family members affected by qualified disasters, not in non-qualified disasters or in emergency hardship situations.

The IRS will presume that payments in response to a qualified disaster, as defined above, made by a private foundation to employees (or family members of employees) of an employer that is a disqualified person (such as a company that is a substantial contributor) are consistent with the foundation's charitable purposes if:

- the class of beneficiaries is large or indefinite (a "charitable class"),
- the recipients are selected based on an objective determination of need or distress, and

- the selection 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 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.

If the requirements of this presumption are met, the foundation's payments in response to a qualified disaster are treated as made for charitable purposes; do not result in prohibited self-dealing merely because the recipient is an employee (or family member of an employee) of the employer-sponsor; and do not result in taxable compensation to the employees.

The presumption described above does not apply to payments that would otherwise constitute self-dealing and subject the organization to excise taxes. 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 foundation or members of the foundation's selection committee.

While a private foundation may fail to meet all of the requirements of the presumption, other procedures and standards may be considered to constitute adequate substitutes to ensure that any benefit to the employer is incidental and tenuous, when all the facts and circumstances are taken into account. Conversely, even though a private foundation meets the presumption, the IRS may still review the facts and circumstances to ensure that any benefit to the employer is tenuous and incidental. 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.

EXAMPLE: A for-profit company is located in an area of the country designated a Presidentially declared disaster because of hurricane devastation. A private foundation funded by the company establishes a new program to provide assistance to the company's employees and their immediate family members who are victims of the current and any future qualified disasters. The foundation's committee that selects recipients for assistance consists of a majority of members who are not in a position to exercise substantial influence over the affairs of the company. The foundation provides assistance to the employees and their families based on an objective determination of need.

The foundation's program does not relieve the company of any legal obligation, such as an obligation under a collective bargaining agreement or written plan that provides insurance benefits. The company does not use the program to recruit employees to continue their employment, or to otherwise follow a course of action sought by the company.

Because the foundation serves a charitable class, provides assistance based on an objective determination of need, and has an independent selection committee, the IRS will presume that it is carrying out a charitable program. Distributions are neither self-dealing transactions between the foundation and the employer nor taxable compensation to its employees under the program.

See the *Life Cycle of a Private Foundation* at www.irs.gov/eo for information about foundation excise taxes, self-dealing and disqualified persons.

For a description of the types of records a private foundation must retain, see the previous section **Documentation**.

Special Tax Rules for Recipients of Disaster Relief Assistance

This part of the publication discusses special tax rules that apply to individuals who receive assistance from public charities, private foundations, employer-related charitable organizations, government entities and other sources in disaster situations.

Gross income, for federal income tax purposes, generally includes all income from whatever source derived, unless a specific exception applies. Whether a payment to a disaster victim constitutes gross income for income tax purposes or compensation subject to employment tax depends, in part, on the source of the payment.

CHARITABLE ORGANIZATIONS—Payments that individuals receive under a charitable organization's program as a result of a disaster or emergency hardship are considered to be gifts and are excluded from gross income of recipients under section 102 of the Code. Payments from an employer-sponsored public charity or private foundation are also exempt from gross income as gifts so long as the requirements described above in **Employer-Sponsored Assistance Programs** are met.

An examination of the facts and circumstances surrounding a charity's payment to a for-profit business will govern whether the business can exclude the amount paid from gross income as a gift under section 102 of the Code. The IRS will evaluate whether the charity intended the payment to be a gift, and was motivated by charitable impulses. If the payment was made out of a moral or legal obligation, an anticipated economic benefit or in return for services, the payment will not be excluded from income as a gift.

FEDERAL AND STATE GOVERNMENT—Generally, payments that individual disaster victims receive from governmental units under social programs for the promotion of the general welfare (i.e. based on need) are not included in the gross income of the recipients of the payments. In addition, certain payments that individuals receive from a state, federal or local government or agency thereof, in connection with a **qualified disaster**, as described above, are excluded from the gross income of the recipient under section 139 of the Code. See **Direct Assistance from Employers and Other Sources** below for additional information about the types of payments excluded from income and employment taxes under section 139.

EXAMPLE: An area within a state was affected by a hurricane that was a Presidentially declared disaster. The state enacted emergency legislation to provide grants to pay or reimburse medical, temporary housing and transportation expenses incurred by individuals as a result of the flood that are not compensated by insurance or otherwise. Payments received under the state's grant program are excluded from income under the general welfare exclusion as well as under section 139 of the Code.

DIRECT ASSISTANCE FROM EMPLOYERS AND OTHER SOURCES—In some instances a corporation or other non-exempt entity may choose to provide direct assistance to disaster victims rather than funneling its assistance through a charity or governmental entity. In addition, sometimes an employer may provide assistance through a non-exempt fund established to receive contributions from the employer as well as employees. In certain circumstances, payments from such sources may receive favorable tax treatment as well. As noted above, section 139 of the Code provides for special tax treatment of **qualified disaster relief payments** made to victims of a **qualified disaster**, regardless of the source. **Qualified disaster relief payments** are not included in the income of recipients to the extent that any expenses compensated by these payments are not otherwise compensated by insurance or other reimbursements. Qualifying payments are

not subject to income tax, self-employment tax, or employment taxes (Social Security, Medicare and federal unemployment taxes) even if the payments are made directly from an employer.

EXAMPLE: A for-profit corporation makes grants to its employees who are affected by a flood that was a Presidentially declared qualified disaster. The grants will pay or reimburse employees for medical, temporary housing, and transportation expenses they incur as a result of the flood that are not compensated for by insurance or otherwise. The corporation will not require individuals to provide proof of actual expenses to receive a grant payment. The corporation's program, however, contains requirements (which are described in the program documents) to ensure that the grant amounts are reasonably expected to be commensurate with the amount of unreimbursed reasonable and necessary medical, temporary housing, and transportation expenses the corporation's employees incur as a result of the flood. The grants are not intended to indemnify all flood-related losses or to reimburse the cost of nonessential, luxury, or decorative items and services. The grants are available to all employees regardless of length or type of service with the corporation.

The grants made by the employer are qualified disaster relief payments expected to be commensurate with the unreimbursed reasonable and necessary personal, living or family expenses of the employees not compensated by insurance or otherwise. The grants are excluded from the employees' gross income under section 139.

Gifts and Charitable Contribution Rules

This part of the publication discusses the tax rules that apply to individuals who want to claim a tax deduction for their contributions to a qualified charitable organization. It also discusses the potential liability of donors for gift tax.

CHARITABLE CONTRIBUTIONS—Contributors to qualified domestic charitable organizations may be eligible to claim federal income tax deductions for their contributions if they file itemized tax returns. Qualified organizations include charitable organizations that the IRS has determined are exempt from federal income tax. Churches, synagogues, temples, and mosques are also qualified charitable organizations.

Domestic charitable organizations are those created under the laws of the United States or its possessions. For charitable contribution purposes, United States possessions include Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, and the Commonwealth of Northern Mariana Islands.

See Publication 526, *Charitable Contributions*, for a complete description of qualified organizations.

Before making a contribution to an organization for disaster relief, a contributor may want to verify whether the contribution would be tax-deductible. A contributor may use any of the following resources to determine if the organization is qualified to accept tax-deductible contributions:

- ▶ Go to “Search for Charities” on the Charities and Nonprofits home page on IRS.gov to access an online version of Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*, for a list of qualified charitable organizations at www.irs.gov/eo
- ▶ Call IRS Exempt Organizations Customer Service at (877) 829-5500 (Toll-Free)

Potential contributors, like other interested members of the public, may obtain a copy of an organization’s exemption application or its recent annual information returns (Form 990, 990-EZ, 990-PF, or 990-N).

Contributors can contact the organization directly or submit Form 4506-A, *Request for Public Inspection or Copy of Exempt Organization IRS Form*, to the IRS to receive copies of the completed forms. Some organizations also post the forms on their website. An organization’s Form 990-N may be accessed via www.irs.gov/eo.

A contributor cannot claim a tax deduction for any cash, check or other monetary contribution to a qualified charitable organization made on or after January 1, 2007, unless the donor maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or a written communication from the charity (such as a receipt or a letter) showing the name of the charity, the date of the contribution, and the amount of the contribution. For more information about contributions, see Publication 526, *Charitable Contributions*.

In addition, a donor cannot claim a tax deduction for any single contribution of \$250 or more unless the donor obtains a contemporaneous acknowledgment of the contribution from the recipient organization. For detailed information on

what a charity is required to include in written acknowledgement statements given to donors, see Publication 1771, *Charitable Contributions—Substantiation and Disclosure Requirements*.

FOREIGN CONTRIBUTIONS—Contributions to qualified domestic charitable organizations that provide assistance to individuals in foreign countries qualify as tax-deductible contributions for federal income tax purposes, provided the U.S. organization has full control and discretion over the uses of such funds. If the contributor is a corporation, its contributions for use in a foreign country are not deductible unless the domestic charity is itself organized as a corporation for federal tax purposes.

Contributions to foreign organizations are generally not tax-deductible, unless permitted by a tax treaty. The United States currently has tax treaties with Canada, Mexico, and Israel. See Publication 526, *Charitable Contributions*, for limitations that apply pursuant to these treaties.

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. However, individual recipients of gifts are generally not subject to federal income tax on the value of the gift. If you make a gift directly to an individual, you are not subject to federal gift tax unless the total gifts made in a year exceed the annual exclusion amount.

Sometimes providing financial assistance apart from a qualified charity is desirable.

EXAMPLE: Jim, a college student and a counselor at a summer camp, accidentally rolls his old truck into a lake. The other counselors collect several hundred dollars and give the monies directly to Jim to help with the down payment for another truck. Since the counselors are making gifts to a particular individual, the use of a qualified charitable organization would not be appropriate. The counselors cannot claim tax deductions for their gifts to Jim. However, Jim is not subject to federal income tax on the gift amount. The other counselors would not be subject to federal gift tax if the total gifts made by each counselor to Jim during the year did not exceed the annual exclusion amount.

For more information about the taxability of gifts, see Publication 950, *Introduction to Estate and Gift Taxes*.

Additional Help on Disaster-Related Topics

The IRS has a number of forms and publications on disaster relief and tax exemption that may be helpful to your organization.

FORMS AND PUBLICATIONS

To order free IRS publications and forms, call the IRS at (800) 829-3676.

Download IRS publications and forms at www.irs.gov.

Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*

Publication 526, *Charitable Contributions*

Publication 547, *Casualties, Disasters and Thefts (Business and Non-Business)*

Publication 557, *Tax-Exempt Status for Your Organization*

Publication 561, *Determining the Value of Donated Property*

Publication 584, *Casualty, Disaster and Theft-Loss Workbook (Personal Use Property)*

Publication 584-B, *Business Casualty, Disaster, and Theft Loss Workbook*

Publication 950, *Introduction to Estate and Gift Taxes*

Publication 1600, *Disaster Losses—Help From the IRS*

Publication 1771, *Charitable Contributions—Substantiation and Disclosure Requirements*

Publication 2194, *Disaster Assistance Kit for Individuals*

Publication 2194-B, *Disaster Losses Kit for Businesses*

TELEPHONE ASSISTANCE

The following telephone numbers will connect you to IRS customer service.

(877) 829-5500

IRS Exempt Organizations Customer Account Services

for tax information specific to exempt organizations

(215) 516-2000

IRS International Customer Service

for tax information specific to foreign tax issues

(800) 829-1040

IRS Customer Service

for general tax information

