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COVID-19: Providing Tax-Advantaged Aid to Individuals Through Charitable Organizations

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Last week, President Trump declared the COVID-19 outbreak in the United States a national emergency, unlocking billions of dollars of federal aid for states and localities. The declaration also opened the door for private foundations, including employer-sponsored foundations, to provide emergency aid directly to employees and other individuals who are affected by the virus, under certain circumstances.

Public Charities and Private Foundations

Many employers establish an Internal Revenue Code (IRC) § 501(c)(3) employee emergency assistance fund to provide financial aid to employees facing emergency hardship situations. The latitude that a 501(c)(3) charitable organization has to give aid directly to individuals, and the type of emergency hardship situations that qualify under such programs, differ depending on whether the organization is classified as a “public charity” or a “private foundation” for federal tax purposes.

The distinction between a public charity and a private foundation is largely in the source of funding and the size of the donor base. In general, public charities normally receive a substantial part of their support in the form of contributions from publicly supported organizations, governmental units, and/or the general public, whereas private foundations usually have one or a limited number of sources of funding (typically contributions from a single family or company). In addition, certain 501(c)(3) organizations are classified as public charities regardless of their sources of funding, such as churches, hospitals, and schools.

The distinction is important for purposes of the emergency aid analysis. Because private foundations do not typically solicit funds from the general public, the IRS perceives them as, theoretically, subject to less public scrutiny and oversight than public charities. Accordingly, the federal tax code and accompanying regulations place certain restrictions on the

ability of private foundations to give directly to individuals. For example, scholarships and certain other individual grant programs require the private foundation to obtain pre-approval from the IRS. Private foundations are also usually required to conduct a sometimes onerous process of due diligence, record-keeping, and reporting over grants made to individuals.

Employee Emergency Assistance Funds

While a private foundation is generally permitted to provide aid to individuals for charitable purposes (provided it follows certain protocols referenced above), particular restrictions under the tax code normally prohibit an employer-sponsored private foundation from providing financial assistance to employees of the sponsoring employer, because it could benefit the employer through employee recruitment and retention.

However, the Victims of Terrorism Act of 2001, enacted following the September 11 terrorist attacks, created an exception to this limitation on private foundations in the event of a “qualified disaster,” putting private foundations on par with their counterpart public charities. The exception, now codified in part in Section 139 of the IRC, defines a “qualified disaster” to include a Presidentially declared disaster (among other scenarios).

Accordingly, President Trump’s declaration of the COVID-19 outbreak as a national emergency permits both employer-sponsored private foundations and employer-sponsored public charities to provide financial assistance to employees and their family members affected by COVID-19, as long as certain requirements and safeguards are met to ensure the gift is made for charitable purposes and not for the benefit of the sponsoring employer.[1]

If properly made and documented, a private foundation’s payments to employees of its donor company (other than directors, officers, or trustees of the foundation or members of its selection committee) in response to a qualified disaster are treated as made for charitable purposes. The gifts will not result in prohibited self-dealing, nor will they constitute taxable expenditures for the private foundation.

Further, under Section 139 of the IRC, qualified disaster relief payments from any source are excluded from the recipient’s gross income, and the payments are not subject to employment taxes or withholding. This applies regardless of whether made by a public charity or a private foundation.

“Qualified disaster relief payments” include payments received for 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; and reasonable and necessary expenses incurred for the repair or replacement of the contents of a personal residence due to a qualified declared disaster. The term does 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. The type and amount of aid that is appropriate will generally depend on the individual’s needs and resources, as well as the particular facts and circumstances of the disaster.

Other Considerations for Charitable Emergency Relief Payments

- If a charitable organization carries on disaster relief activities as one of its largest programs, it must describe the services provided in its annual IRS informational return (Form 990 or Form 990-EZ in the case of public charity; Form 990-PF in the case of a private foundation).

- Before providing emergency and hardship assistance directly to individuals, a charitable organization (particularly a private foundation) must confirm this activity is not prohibited by its Articles of Incorporation and Bylaws or by any other governing documents.
- Contributions to charitable organizations may be earmarked specifically for COVID-19 relief, but they may not be earmarked for the benefit of a particular individual or family.
- If a charity represents to donors that funds will be used for a specific purpose (*e.g.*, for COVID-19 relief aid), state and local laws generally require that the funds raised in that solicitation be used only for that stated purpose.

The Treasury Regulations addressing employee emergency relief funds are nuanced. Specific processes and parameters—including a properly structured selection committee and selection criteria, an appropriately defined potential pool of beneficiaries, and an adequate due diligence and record-keeping process—must be followed in order for the tax advantages described in this article to apply and, in the case of private foundations, to avoid triggering excise taxes for the foundation when providing aid to individuals.

We welcome you to reach out to Elizabeth Prendergast (who authored this article), your Michael Best attorney, or our firm’s COVID-19 Task Force for specific guidance on these and other rapidly emerging issues.

[1] Note that employer-sponsored private foundations are still restricted from making payments to employees or their family members affected by non-qualified disasters or in other emergency hardship situations that do not meet the definition of a qualified disaster.

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