
New Rules for Grantmakers and Donors

An Overview for Private Foundations,
Organizations Sponsoring
Donor-Advised Funds, and Donors

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NOTE: This report is provided for informational purposes and is not intended to serve as legal or tax advice. If you have questions about the laws and regulations governing charitable distributions and gifts, consult your legal or tax advisor.

The IRS has updated the rules under which grantmakers, contributors, and donors can make grants and deduct charitable contributions. Effective June 20, 2011, IRS Revenue Procedure 2011-33 modifies the sources “grantors and contributors (including donors)” can use to determine whether contributions to a nonprofit are tax-deductible, whether private foundations and sponsors of donor-advised funds must exercise expenditure responsibility (that is, ensure that a grant or contribution is used for charitable purposes), and whether distributions count toward a private foundation’s minimum payout.¹

This report reviews the steps grantmakers and donors must take to comply with the revised IRS requirements, the importance of documenting due diligence (that is, research into a nonprofit’s eligibility to receive charitable gifts), and what can happen if grantors and contributors give to nonprofits without doing this research, use the wrong sources for their research, or fail to document their due diligence.

What the IRS Requires Grantmakers and Donors to Do

1. **Verify the nonprofit’s eligibility to receive a tax-deductible charitable contribution.**

Verifying eligibility has three parts:

- a. **Establishing whether the organization is allowed to receive tax-deductible contributions.**
Not all tax-exempt organizations are qualified to receive charitable contributions (the formal term for tax-deductible gifts and donations). Before making a charitable grant or donation, a grantor or contributor must confirm that the recipient is eligible to accept it.

Compliance Checklist

1. Verify the recipient’s eligibility to receive a charitable gift.
2. Determine if the recipient is a supporting organization. If it is, determine what type.
3. Confirm that the recipient does not appear on the OFAC list of organizations and persons linked to terrorism.

Who Needs to Be Concerned?

1. 501(c)(3) private foundations
2. Organizations sponsoring donor-advised funds, including community foundations
3. Corporate giving programs
4. Federated giving programs
5. Individual donors
6. Donor advisors

Previously, the IRS required donors and grantors to do this research using IRS Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*.² Rev. Proc. 2011-33, however, specifies that grantmakers and donors may use *either* Publication 78 or the IRS Business Master File (BMF)³ to research eligibility.

b. Confirming the recipient's foundation and deductibility status.

Most organizations that are eligible to receive tax-deductible contributions are 501(c)(3) charitable organizations. Some other types of nonprofits are qualified to receive tax-deductible gifts, but special rules and restrictions may apply.

In the case of an individual donor, the amount of a charitable deduction is limited to a percentage of the individual's income. The amounts that can be deducted for donations to private foundations are lower than the amounts for public charities. Additionally, other facts may affect the amount that can be deducted.

Private foundations and sponsors of donor-advised funds must exercise expenditure responsibility for contributions to certain organizations.

Before making a contribution or a grant, donors and grantmakers must research the information that determines the amount of the donor's deduction and whether a grantmaker must exercise expenditure responsibility.

Although previously the IRS required donors and grantmakers to use Publication 78 for this research, Rev. Proc. 2011-33 now allows them to use *either* Publication 78 or the BMF. Both sources provide a "deductibility code."

c. Determining whether the recipient is in good standing with the IRS.

The Pension Protection Act of 2006 revokes the tax-exempt status of any nonprofit that is required to file an annual return (Form 990, 990-N, 990-EZ,

or 990-PF) but fails to do so for three consecutive years. The act also requires the IRS to publish a list of these organizations. Revocations are automatic and mandatory under the law. This provision of the act went into effect on June 8, 2011, when the IRS published the first Automatic Revocation of Exemption List. The list identified 275,000 organizations whose exemptions had been automatically revoked for failure to file annual returns for three consecutive years; it will be updated regularly.⁴

The IRS also revokes exemptions of nonprofits on a case-by-case basis for serious noncompliance with other requirements of the U.S. Tax Code. These revocations are published in the Internal Revenue Bulletin⁵ or on the IRS Web site, www.irs.gov.

An organization that has had its tax-exempt status revoked is no longer eligible to receive tax-deductible contributions. Although it may continue to accept contributions, those gifts are not tax deductible. Additionally, although private foundations and sponsors of donor-advised funds may continue to make grants to organizations whose tax-exempt status has been revoked, they will be required to exercise expenditure responsibility over those grants.

Before making a contribution or grant, donors and grantors must confirm that the recipient remains in good standing with the IRS, i.e., that the IRS has not revoked its tax-exempt status. Grants and contributions to an organization whose tax-exempt status has been revoked that are made *on or before* the date the IRS publishes notice of the revocation are tax deductible and allowable by private foundations and sponsors of donor-advised funds. Any grants and donations made to the organization after that date are not.⁶

2. Determine if the nonprofit is a supporting organization. If it is, determine what type.

The Pension Protection Act of 2006 restricts distributions to certain types of supporting organizations (a supporting organization is a charity established for the purpose of providing support to another charity). There are different types of supporting organizations, and the type determines whether grantors must exercise expenditure responsibility and whether the grants count toward a private foundation's minimum payout.

The IRS allows grantmakers to research supporting organization status, also known as 509(a)(3) status,⁷ in one of four sources:

- a. a charity's IRS letter of determination, the document in which the IRS approves a nonprofit's application for tax-exempt status;
- b. the BMF;
- c. a third-party source of BMF data that meets certain criteria;⁸ or
- d. Publication 78.

If a grant recipient is a supporting organization, a grantmaker must determine what type. Publication 78, however, does not identify supporting organizations at all and, at this time, the BMF lists the type of supporting organization for only a handful of charities. Until this information is fully integrated into Publication 78 and the BMF, grantors must conduct additional research on their own on organizations that are supporting organizations to determine the type.

3. Confirm that the recipient does not appear on the OFAC list of organizations and persons linked to terrorism.

Adopted after 9/11, the USA PATRIOT (Unite and Strengthen America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism)

Act prohibits U.S. persons from making financial contributions to, or having any other dealings with, organizations linked to terrorism.⁹ The Office of Foreign Assets Control (OFAC) at the U.S. Department of the Treasury maintains lists of individuals and organizations whose assets have been frozen because of suspected ties to terrorism; such persons and entities are identified as "Specially Designated Nationals" or "SDNs."¹⁰

If there is any possibility that an intended gift recipient may have been linked to terrorism, grantors and contributors should consult OFAC publications to confirm that the nonprofit is not an SDN.

Consequences of Not Following the Rules

Failure to do the necessary research, or using the wrong resources for it, can have negative repercussions for both grantmakers and individual donors. Grantors that make charitable distributions to ineligible organizations or fail to exercise expenditure responsibility when required put their organizations at risk of excise taxes. The penalties stemming from gifts to ineligible supporting organizations are particularly steep. Similarly, donors who give to ineligible nonprofits may find that their charitable deductions are disallowed and may be required to pay penalties to the IRS.

Giving money to an organization that the U.S. government has named an SDN is a crime. Grantors and donors who contribute to nonprofits on the OFAC lists put themselves at risk of prosecution.

To prevent such outcomes, grantmakers and donors should document their research so that, should the IRS question a distribution or gift, they can demonstrate that they performed their due diligence in the appropriate resources *before* the grant or contribution was made. This evidence can be kept in electronic or printed form. Documenting the date of the research is particularly important.

Conclusion

The old saying “an ounce of prevention is worth a pound of cure” applies to grantmaking and charitable giving. Failing to do your homework can end up costing you or your organization money—or even place you on the wrong side of a courtroom.

- 1 Rev. Proc. 2011-33 can be found in Internal Revenue Bulletin 2011-25, June 20, 2011, <http://www.irs.gov/pub/irs-irbs/irb11-25.pdf>, pp. 887-890. Quotation found on p. 887. Rev. Proc. 2011-33 supersedes Rev. Proc. 1982-39, http://www.irs.gov/pub/irs-tege/rp1982_39.pdf, and Rev. Proc. 2009-32, http://www.irs.gov/pub/irs-tege/rp2009_32.pdf, pp. 142-143.
- 2 Search for Charities, Online Version of Publication 78, <http://www.irs.gov/app/pub-78/>.
- 3 SOI Tax Stats—Exempt Organizations: IRS Master File Data, <http://www.irs.gov/taxstats/charitablestats/article/0,,id=97186,00.html>.
- 4 Automatic Revocation of Exemption, <http://www.irs.gov/charities/article/0,,id=239696,00.html>; GuideStar, “IRS Revokes Tax-Exempt Status of 275,000 Nonprofits,” June 9, 2011, <http://www2.guidestar.org/rxa/news/news-releases/2011/irs-revokes-exemptions-of-275000-nonprofits.aspx>.
- 5 Copies of recent Internal Revenue Bulletins can be found at <http://www.irs.gov/irb/>.
- 6 Section 3 of Rev. Proc. 2011-33 states that “grants and contributions” made to a nonprofit whose exempt status has been revoked “by persons unaware of such change in status of the organization generally will be considered allowable if made on or before the date of an appropriate public announcement stating that the organization ceases to qualify as an organization contributions to which are deductible under § 170” (p. 889).
- 7 A 509(a)(1) or 509(a)(2) organization is *not* a supporting organization and is eligible to receive charitable distributions under the Pension Protection Act of 2006. A charity listed as a 509(a)(3) organization *is* a supporting organization, and a grantor must do additional research on the nonprofit to determine if it is qualified to receive a distribution and, if it is, whether it will be necessary to exercise expenditure responsibility.
- 8 Rev. Proc. 2011-33 states that grantmakers and donors can rely on a third-party source of BMF data as long as “(1) The third party provides a report to the grantor or contributor that includes: (A) the organization’s name, EIN, foundation status under § 509(a)(1), (2), or (3) (including supporting organization type, if applicable), and whether contributions to such organization are deductible; (B) a statement that the information is from the most current update of the BMF extract and the BMF extract revision date; and (C) the date and time the information was provided to the grantor or contributor; and (2) The grantor or contributor retains a copy of the report in hard copy or electronically” (I.R.B. 2011-25, June 20, 2011, p. 889).
- 9 The text of the act is available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_bills&docid=f:h3162enr.txt.pdf.
- 10 To view this information, use the links on the “Resource” tab on <http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>.