

## **K. DISASTER RELIEF AND EMERGENCY HARDSHIP PROGRAMS**

by

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### Part I. Community Assistance Organizations

#### Introduction

On the occurrence of a natural or civil disaster or an emergency hardship, the general community comes together to alleviate human suffering. The same reaction occurs when a fellow employee is affected by a severe financial hardship in the family due to illness, death, accident, crime, or similar circumstances, where the employee has exhausted the means to cope with the situation. Under these circumstances, federal and state relief agencies, individuals, charities, and private corporations gather their resources, human and financial, to minimize the suffering. Often, charities are created to provide disaster relief and/or emergency hardship assistance and file for recognition of exemption from federal income tax as charitable organizations described in IRC 501(c)(3). Existing charities sometimes request rulings from the Internal Revenue Service regarding the effect of such a program on their tax exempt status or with respect to the private foundation provisions. At times, organizations want to also know whether disaster relief and emergency hardship grants are excludable from a recipient's taxable income under the gift exclusion. The Service has seen an increase in requests where disaster relief and emergency hardship programs are keyed to employment eligibility. This article focuses on principles applicable to disaster relief and emergency hardship programs in general. It also sets forth principles specifically applicable to employer related programs.

#### A. Expedite Handling

In situations involving disaster relief or emergency hardship programs where time is of the essence, the Service's established procedures permit organizations to request expedite handling by filing a letter asking for expedite treatment with the exemption application or ruling request. In addition, applications for recognition of exemption or ruling requests that require expedite handling should also be marked at the top with a notation as follows: "Disaster Relief/Emergency Hardship Expedite." Rev. Proc. 98-4, 1998-1 I.R.B. 113, 135, at section 9.03:(3).

#### B. Types of Assistance Provided

Disaster relief organizations may provide loans or grants in the form of funds, services, or goods to ensure that victims of a disaster have the basic necessities such as food, clothing, housing (including household repairs), transportation, and medical assistance (including psychological help). The type of aid that is appropriate to relieve distress in a particular case depends on the individual's needs and resources. Individuals might be in need of short term assistance but not long term assistance. For example,

following a devastating flood, a family may be in need of funds to meet immediate necessities because its readily available cash flow (income, insurance proceeds, etc.) or other resources are inadequate or unavailable. Or they may need basic necessities that are not available for purchase because of the nature of the disaster. The same family, however, may not have the need for a low interest loan for home repair because its home is covered by insurance or it can reasonably obtain and repay a commercial loan. Another family or individual may have suffered the loss of a family member and may need financial assistance with funeral expenses or help with the cost to have immediate family members attend the burial, which would help promote the family's emotional healing.

Emergency hardship organizations typically provide loans or grants in the form of funds, services and/or goods for basic necessities to needy individuals who have encountered financial hardship for reasons beyond their control. Therefore, emergency hardship assistance is comparable to disaster relief assistance in that individuals may need short term or long term assistance depending on the facts and circumstances. For example, a family may need short term financial help to meet basic necessities on account of a crime they have suffered. Another family, however, may need longer term financial assistance on account of chronic health care costs that are not covered by insurance and for which resources are either inadequate or unavailable.

### C. Bases for Exempt Status

#### (1) Relief of the Poor and Distressed

Generally, disaster relief organizations are exempt under IRC 501(c)(3) as organizations formed for the relief of the distressed. The beneficiaries are individuals who find themselves in a distressed condition. The legal doctrines applicable to charitable trusts, as developed in judicial decisions, recognize that trusts for the purpose of aiding victims of fires, earthquakes, drought and similar calamities are charitable. See IV-A Scott, The Law of Trusts, section 375.2 (4th Ed. 1989); Bogert, Trusts and Trustees, section 379 (2nd Ed. Rev. 1977). Similarly, emergency hardship organizations further charitable purposes by providing assistance to the distressed. Rev. Rul. 56-304, 1956-2 C.B. 306, provides that an organization that makes distributions to needy individuals may qualify for exemption; however, adequate case histories and records should be maintained. Also, Rev. Rul. 55-406, 1955-1 C.B. 73, provides that an organization that provides funds to benefit dependent widows and children of policemen and firemen who lose their lives in the line of duty may qualify for exemption where selection of recipients and amounts distributable to them are determined in the absolute discretion of the organization's directors. Charitable purposes under IRC 501(c)(3) include relief of the poor and distressed or of the underprivileged as provided by Regs. 1.501(c)(3)-1(d)(2). Persons who are financially unable to care for themselves as a result

of sudden and severe or overwhelming financial burdens arising from events beyond their control are proper objects of charity because they are considered to be "distressed." Other helpful descriptions of persons who are appropriate charitable beneficiaries can be found in the following descriptions applicable to the charitable deduction under IRC 170.

Regs. 1.170A-4A(b)(2)(ii)(D) defines "needy" as describing a person who lacks the necessities of life, involving physical, mental, or emotional well-being, as a result of poverty or temporary distress. Examples of needy persons include a person who is financially impoverished as a result of low income and lack of financial resources, a person who temporarily lacks food or shelter (and the means to provide for it), a person who is the victim of a civil disaster (such as civil disturbance), a person who is temporarily not self-sufficient as a result of a sudden and severe personal or family crisis (such as a person who is the victim of a crime of violence or who has been physically abused), a person who is a refugee or immigrant and who is experiencing language, cultural, or financial difficulties, a minor child who is not self-sufficient and who is not cared for by a parent or guardian, and a person who is not self-sufficient as a result of previous institutionalization (such as a former prisoner or a former patient in a mental institution).

Regs. 1.170A-4A(b)(2)(ii)(E) defines care of the needy as alleviation or satisfaction of an existing need. Since a person may be needy in some respects and not needy in other respects, care of the needy must relate to the particular need which causes the person to be needy. For example, a person whose temporary need arises from a natural disaster may need temporary shelter and food but not recreational facilities.

A finding of charitable status may be based on the organization's efforts to relieve the distressed condition, irrespective of whether the recipients are poor or destitute, or prior to the disaster, were members of a charitable class. For example, Rev. Rul. 79-18, 1979-1 C.B. 194, provides that housing for the elderly furthers a charitable purpose by relieving a distress to which the elderly may be susceptible regardless of financial condition; Rev. Rul. 79-17, 1979-1 C.B. 193, provides that a hospice facility for terminally ill persons in need of specialized housing furthers a charitable purpose by relieving their distress; Rev. Rul. 78-99, 1978-1 C.B. 152, provides that an organization that provides counseling to widows during periods of grief and assists them in overcoming the legal, financial and emotional problems caused by the death of their husbands qualifies as charitable by alleviating the widows' distress; and Rev. Rul. 69-174, 1969-1 C.B. 149, provides that an organization that provides free emergency rescue services to stranded, injured, or lost persons and to persons suffering because of fire, flood, accident or other disaster is serving a charitable purpose.

(2) Other Charitable Purposes

There are other charitable bases for exempt status of disaster relief and emergency hardship organizations, such as promoting patriotism and lessening the burdens of government. For example, an organization formed to provide active duty personnel with reading material and entertainment would be considered exempt as it would increase the morale of military personnel. The organization promotes patriotism. Increasing preparations for war, increasing soldiers' professional competence, and supplying better food or literature are charitable activities. Scott at section 374.3. The law of charity also contemplates assistance to the families of soldiers both during and after war. Bogert at section 378. Thus, for example, a fund may provide for the education and health care of dependents of armed services personnel killed in action, which would promote health or education in addition to, or instead of, alleviating distress.

A disaster relief organization can also qualify for exemption if it lessens the burdens of government. The organization must show that its activities are those a governmental unit considers to be its burdens, and that the activities of the organization actually lessen a governmental burden. These elements are established by the facts and circumstances, such as an objective manifestation by the government unit that the activity is a governmental burden, or that there is a favorable working relationship between the organization and the government. However, the mere fact that an organization engages in an activity that is sometimes undertaken by government, or that a governmental official expresses approval of an organization or its activities, is insufficient to establish that the organization is lessening governmental burdens. For example, an organization that provides rental housing and related services at cost to a city for its use as free temporary housing for families whose homes have been destroyed by fire was held not to qualify for exemption because the city was providing the charity. There were no objective manifestations that the organization was undertaking a governmental burden. See Rev. Rul. 77-3, 1977-1 C.B. 140. However, Rev. Ruls. 85-1 and 85-2, 1985-1 C.B. 177, 178, describe organizations that were found to lessen governmental burdens based on objective manifestations demonstrating that the government acknowledged the burden and that the organization actually lessens that burden.

The principle that a disaster relief organization may lessen the burdens of government was acknowledged in Rev. Rul. 74-361, 1974-2 C.B. 159. There, the Service recognized a long-standing line of cases holding that providing fire and rescue service for the general community lessens the burdens of government.

D. Charitable Class

(1) Indefiniteness Requirement

A basic principle of the law of charity is that a trust must be formed for the benefit of the community, rather than an individual. Where a trust is created for the benefit of designated individuals, it will fail if the class of persons to be benefited is so narrow that the community has no interest in the performance of the trust. The rule that a charitable organization must not serve private interests excessively is a long-established one and is based on an essential ingredient of charity law, that the organization be organized to serve the public interest. IV-A, Scott, section 375, fully cited above.

A [charitable] trust may fail because the class of persons who are to benefit is so narrow that the community has no interest in the performance of the trust. It is a question of degree whether the class is large enough to make the performance of the trust of sufficient benefit to the community so that it will be upheld as a charitable trust. If the purpose of the trust is to relieve poverty, promote education, advance religion, or protect health, the class need not be as broad as it must be where the benefits to be conferred have no relation to any of these purposes. On the other hand, the class of persons to be benefited may be so limited that the trust is not charitable even though the purpose of the trust is to relieve their poverty, to educate them, or to save their souls, or to promote their health.

Similarly, Regs. 1.501(c)(3)-1(d)(1)(ii) provides that a charitable organization must be organized and operated to serve public rather than private interests.

In Russell v. Allen, 107 U.S. 163, 167 (1882), the Supreme Court stated that charitable trusts "may, and indeed must, be for the benefit of an indefinite number of persons; for if all the beneficiaries are personally designated, the trust lacks the essential element of indefiniteness, which is one characteristic of a legal charity." Similarly, the Tax Court noted in a situation involving amounts paid for the benefit of a designated ward of a charitable organization that "charity begins where certainty in beneficiaries ends, for it is the uncertainty of the objects and not the mode of relieving them which forms the essential element of charity." Thomason v. Commissioner, 2 T.C. 441, 443 (1943). A number of factors, in addition to indefiniteness, are important in evaluating the presence of a charitable class.

(2) Factors to be Considered

a. Size of the Class to be Benefited

The element of public interest may be supplied through the large size of the group from which ultimate beneficiaries will be chosen. Bogert at section 363. It is a question of degree whether the class is large enough to make the performance of the trust of sufficient benefit to the community so that it will be upheld as charitable. Scott at section 375. For example, an organization formed for the purpose of assisting the victims of a hurricane, terrorist attack or similar disaster of mass proportion may be less susceptible to being formed for the benefit of a limited class, even though the number of potential beneficiaries may be fixed, as the affected individuals most likely will encompass an entire community or other significant measure. See O.D. 345, 1 C.B. 151 (1919) where an organization formed to obtain donations for the reconstruction of Puerto Rico after an earthquake and tidal wave was charitable. The number of eligible beneficiaries necessary to constitute a charitable class is usually less a matter of the actual number, than a matter of all the facts and circumstances that demonstrate whether beneficiaries are pre-selected. For example, where the eligible class of beneficiaries constitutes a mere handful of persons and the benefit is likely to be utilized by just one or two persons within the class, pre-selection has occurred.

b. Open or Closed Class of Beneficiaries

A disaster relief or emergency hardship organization will avoid the problem of a limited class if, in addition to meeting the other organizational and operational requirements, it defines its class of beneficiaries in an "open-ended" manner. For example, an organization might be formed to aid those injured or killed while undertaking fire fighting efforts. This open-ended class would include victims of future fires, rather than being limited to victims of a particular fire. If the class is open-ended, the presence of ascertainable beneficiaries does not preclude exemption under IRC 501(c)(3). However, the class must be truly open. If an organization operates to benefit particular individuals, the fact that it broadly describes a theoretical class of beneficiaries will not save it. Bogert at section 363. Rev. Rul. 56-403, 1956-2 C.B. 307, held that the awarding of scholarships by a foundation solely to undergraduate members of a designated fraternity will not preclude it from exemption as the scholarships are not limited to present members of the fraternity. Conversely, an organization whose sole activity is the operation of a scholarship plan for making payments to pre-selected, specifically identified individuals does not qualify for exemption. Rev. Rul. 67-367, 1967-2 C.B. 188. Similarly, for example, a trust formed to aid members of a specific college graduating class and their families who become destitute or disabled would not qualify for exemption. Even though members of that class who become destitute or disabled may be appropriate objects of charity, the organization would be directing its aid to a closed class of pre-selected individuals. G.C.M. 39876 (July 29, 1992).

c. Impetus for Organization's Formation

The catalyst for the formation of an organization may reveal that the organization was established for the benefit of pre-selected individuals, even though the organization is ostensibly set up to benefit an open-ended class. For example, an organization formed out of concern for an individual in need of a bone marrow transplant may be solely or substantially formed to serve the interests of the individual as opposed to the required charitable class. The court in Wendy Parker Rehabilitation Foundation, Inc. v. Commissioner, T.C. Memo 1986-348, found that the fact that the organization had been formed in response to Wendy Parker's coma was significant in determining the purposes of the organization.

d. Name of the Organization

The naming of an organization after an individual victim may indicate that its purpose is to serve a pre-selected individual's interest, if other facts and circumstances also demonstrate this purpose. The court in Wendy Parker noted the organization's name as an indication of its purpose.

e. Earmarked Funds

The presence of earmarked funds or contributions for the benefit of specifically designated individuals would suggest the organization is formed for the benefit of the designated individuals. In Wendy Parker the court also noted that funds were mostly contributed by the family of Wendy Parker which also retained control over the organization. For example, in a situation involving a fire in a building where many people are killed or injured, charitable funds may be used and set aside currently with a preference for the immediate victims and their families provided there is a bona fide purpose to aid others in similar circumstances in the future. With respect to the actual selection of appropriate beneficiaries for future relief, such as educational grants for children of victims, appropriate criteria for selection would include need and/or merit at the time the grant is awarded. Rev. Rul. 69-257, 1969-1 C.B. 151.

f. Publicity Concerning the Availability of Funds

Publicity concerning the availability of funds may indicate that the organization seeks to assist anyone who fits its criteria, rather than having established the criteria to justify aid to a narrow, pre-selected class of persons. Conversely, a lack of publicity may indicate that the organization seeks to benefit a limited class.

g. Broad Community Involvement

Broad community involvement decreases the possibility that the organization serves narrow private interests, rather than the broader interests of the community. Community involvement could be found in fund raising, contributions, board or other leadership positions, or other forms.

h. Duration of Organization

It is not unusual for a disaster relief organization to be of limited duration, and while limited duration is not inconsistent with exemption, it may raise some questions as to the intent of the organization and the issue of indefiniteness of beneficiaries. However, organizations formed for assisting victims of disasters where a significant portion of the community is affected, are less susceptible to being formed for the benefit of a limited class, even though the number of potential beneficiaries may be fixed. See IV-A, Scott, section 375.2, supra.

i. Plan for Distribution of Excess Funds

An organization formed for a particular disaster or for a limited duration should have a plan for distribution of excess funds at the termination of the organization's existence in a manner consistent with the dissolution requirements under IRC 501(c)(3). For example, once the basic necessities have been met, excess funds must be distributed to qualified charities or to the federal, state or local government for a public purpose. Excess funds can not be prorated among the victims.

j. Any Other Relevant Facts and Circumstances

Each situation needs to be considered based on all the facts and circumstances that are presented for consideration.

E. Needs Test

(1) General Requirements

Where an organization distributes funds for the purpose of relieving financial distress, generally it must be a distribution based on the demonstrated need of the individual. This aspect follows from Regs. 1.501(c)(3)-1(d)(2) which includes as charitable relief of the poor and distressed. This would include indigent persons or individuals who are financially needy. Therefore, a disaster relief organization must have in place, prior to any disbursements of funds, a "needs" test or set of criteria by which it can objectively make distributions to financially distressed individuals.

Awards should be made on findings of financial hardship based on a determination that the potential recipient's available cash, assets that can be disposed of without causing further personal hardship, and anticipated cash flow (income, insurance proceeds, etc.) from all sources can reasonably be expected to be insufficient to provide for timely retirement of existing obligations and basic needs as previously described in this article under the heading "Types of Assistance Provided." An organization may elect to extend loans to persons covered by insurance, with the requirement that the recipient repay the loan when the insurance proceeds are received provided insurance is sufficiently adequate so that repayment of the loan does not cause further personal hardship. Alternatively, an organization may determine that a grant is appropriate even to persons covered by insurance depending on the facts and circumstances of a person's overall financial condition and where insurance does not cover all losses. An individual does not have to be totally destitute to be needy, merely lacking the resources to meet the basic necessities.

Evidence of financial need is not necessary when providing nonmonetary assistance such as counseling and other supportive services to individuals in distress. For example, Rev. Rul. 78-99, 1978-1 C.B. 152, provides that providing individual and group counseling to widows to assist them in legal, financial, and emotional problems caused by death of their husbands qualifies as charitable; Rev. Rul. 70-590, 1970-2 C.B. 116, provides that providing a drug rescue center and a telephone drug crisis service for persons with drug problems qualifies as charitable; and Rev. Rul. 71-99, 1971-1 C.B. 151, provides that providing food and drink to firemen, policemen, and other emergency personnel at the scene of fires, riots, and other disasters qualifies as charitable. As previously noted under the heading "Relief of the Poor and Distressed," other situations may be present where individuals may be distressed and require assistance without being financially needy. For example, individuals who are lost at sea or trapped by a snowstorm, flood, or other disaster would constitute a charitable class irrespective of their financial condition.

Making an individual whole on account of a disaster or emergency hardship does not, necessarily, further charitable purposes. The amount needed to relieve the distress should be based on all the facts and circumstances of the individual's situation and the charity's resources. An outright transfer of funds based solely on an individual's involvement in a disaster or without regard to meeting the individual's particular distress or financial needs would result in private benefit. For example, if an individual's uninsured vacation residence is destroyed in a disaster, that person would have undergone a loss. But, it does not follow that the person is therefore distressed and needy. Maintaining a person's standard of living at a level satisfactory to that person rather than at a level to satisfy basic needs could also serve private interests. For example, rebuilding an individual's luxury estate would serve a private rather than a public interest where meeting the individual's basic needs may be limited solely to providing temporary housing. Similarly, grants to replace lost income rather than to meet basic living needs would generally be viewed as serving personal and private interests.

(2) Terms of Assistance

As previously noted, Rev. Rul. 56-304 states that adequate records and case histories should be maintained to justify the individual grants as being in furtherance of charitable purposes. However, the amount of detail required to document a charitable program will vary depending on the circumstances. In the initial stages of a relief effort there may be an urgent need for immediate action to provide short term assistance, such as for food, clothing, temporary housing, temporary housing repairs, immediate medical care, funeral services, and other critical needs. During this phase of a relief effort, only a minimum of information would generally be required to be collected from recipients. In most cases, records containing basic information such as names, addresses, telephone numbers, social security numbers, a brief description of loss suffered, and the type and amount of assistance needed and granted should be maintained. However, in some emergency circumstances, it may be sufficient merely to provide assistance to the distressed without even obtaining this minimal information provided there is some recordation concerning the uses to which the funds were put.

After immediate critical needs have been satisfied, complete and appropriate documentation for providing aid to satisfy long term needs must be maintained to demonstrate the charitable nature of the relief. For example, in considering financial need an organization should consider evidence of an applicant's financial condition such as available cash, expenses, other financial obligations, assets that can be disposed of without causing further personal hardship, and anticipated cash flow (income, insurance proceeds, etc.). This information should be considered to determine whether such resources are insufficient to provide for timely retirement of existing obligations and the continuing basic living requirements (food, housing, clothing, medical care, transportation, household repairs, or other similar necessities).

F. Furthering Private Interests Generally

A disaster relief or emergency hardship organization may be formed ostensibly for the benefit of distressed individuals but may serve to further the private interests of its founders, principals, or even contributors, thereby failing to achieve exemption despite otherwise good intentions. For example, in Wendy Parker, *supra.*, the organization was created by the Parker family to aid an open-ended class of "victims of coma;" however, the organization stated that it anticipated spending 30 percent of its income for the benefit of Wendy Parker, significant contributions were made to the organization by the Parker family, and the Parker family controlled the organization. Wendy's selection as a substantial recipient of funds benefited the Parker family by assisting with the economic burden of caring for her. The benefit did not flow primarily to the general public as required under Regs. 1.501(c)(3)-1(d)(1)(ii).

Similarly, in Calloway Family Association, Inc. v. Commissioner, 71 T.C. 340 (1978), an organization formed to study immigration to and migration within the United States focused on the Calloway's own family history and genealogy. The family genealogical activities substantially furthered private interests.

Also, in Ohio Teamsters Educational and Safety Training Trust Fund, 77 T.C. 189 (1981), aff'd 692 F.2d 432 (6th Cir. 1982), a scholarship fund set up pursuant to a collective bargaining agreement between a union and an association was operated to satisfy the employer's negotiated obligation to its employees in securing their services.

### G. Practical Application

Frequently, a particularly tragic event affecting one person or a small group of persons is the impetus for an outpouring of assistance from a sympathetic public. Pre-selection can be avoided where the relief program is established to include as the eligible class all similarly situated persons provided the program is also administered on an objective basis with respect to the particular person(s) whose misfortune precipitated the program. Some keys that are helpful in ensuring the presence of a charitable class that is open ended rather than pre-selected are (1) requiring the person(s) to satisfy the same objective criteria for assistance as will be applied to all other applicants, (2) no earmarking of amounts specifically for a designated individual, (3) ensuring that funds are not solely administered by persons who are in a position to privately and personally benefit if a particular person receives assistance, and (4) ensuring that in the program's organization and operation, such as through publicity and solicitation of contributions, the objective of the fund to assist all persons in a similar distressed and/or needy situation is emphasized. Ultimately, pre-selection is based on all the relevant facts and circumstances.

In the rush to provide assistance organizers frequently spend a lot of time and funds to establish and qualify a separate charitable organization. And this may be appropriate where the organizers have long term goals or where there is no suitable existing charity to which they can direct their funds and energy. Alternatively, an existing charitable organization such as a community fund, church or charity operating in an allied area may be interested in establishing a program to which contributions could be directed to provide the assistance that is needed. This may be a more practical approach than the establishment of a new charity. Certainly, the same rules that are discussed throughout this chapter would apply to a program operated within an existing charitable organization.

## Part II. Employee Assistance Organizations

### 1. General

Organizations established to provide disaster relief and/or emergency hardship financial support for persons who are affiliated with a particular profession or employer may qualify for exemption under IRC 501(c)(3). For example, an organization that distributes contributions for the benefit of surviving spouses and children of police officers and fire fighters killed in the line of duty qualifies under IRC 501(c)(3) where the organization's board of directors selects the recipients based on objective criteria that establish need and those eligible for benefits are not members of the organization. Rev. Rul. 55-406, 1955-1 C.B. 73. This is comparable to Rev. Rul. 56-403, *supra.*, which held that a scholarship fund established for undergraduate members of a particular fraternity furthered charitable purposes where membership in the fraternity was open ended, selection of recipients was made on objective factors, and the fund did not provide benefits to its members.

Mutual benefit organizations generally cannot qualify under IRC 501(c)(4) (nor by extension under IRC 501(c)(3)) because they primarily serve the private interests of their members rather than the common good and general welfare of the community. Rev. Rul. 75-199, 1975-1 C.B. 160, provides that an organization that derives income principally from membership dues used to provide sick and accident benefits limited to members of a particular ethnic group residing in a stated geographical area is not exempt because it is essentially a mutual, self-interest type of organization. Rev. Rul. 81-58, 1981-1 C.B. 331, describes a membership organization that primarily provides retirement and death benefits to its members who are limited to members of an organization of police officers. Although the class of employees benefited consist of police officers engaged in the performance of essential and hazardous public services so that there is an incidental benefit provided by the organization to the larger community, the association is essentially a mutual, self-interest type of organization that primarily benefits its members. Therefore, the organization is not operated exclusively for the promotion of social welfare within the meaning of IRC 501(c)(4) (nor by extension for exclusively exempt purposes within the meaning of IRC 501(c)(3)).

Accordingly, an employee disaster relief or emergency hardship organization established and funded mostly by employees or by persons engaged in a particular profession (e.g. nurses, teachers, police officers) to provide assistance to such employees of a particular employer or such persons engaged in a particular profession during times of hardship caused by death, illness, financial distress, or similar conditions may qualify under IRC 501(c)(3). The organization will be operated exclusively for charitable purposes even though it serves a group of individuals designated by employment related factors provided that it benefits a charitable class of individuals and does not provide benefits based on membership in the organization.

It is also important that such organizations are not established to serve a nonexempt purpose of serving an employer's private interests to more than an insubstantial amount such as by providing a vehicle to compensate or otherwise provide an employment benefit to employees of a particular employer. For example, in Ohio Teamsters Educational and Safety Training Trust Fund, *supra.*, the court held that a scholarship fund set up pursuant to a collective bargaining agreement between a union and an employer was not operated exclusively for exempt purposes described in IRC 501(c)(3) notwithstanding the fact that the activities to some extent furthered charitable purposes. The fund was operated to satisfy the employer's negotiated obligation to its employees in securing their services. See also Copperweld Steel Company's Warren Employee's Trust v. Commissioner, T.C. Memo. 1991-7 (Jan. 14, 1991), in which the Tax Court deferred to the Service's position that a trust fund operated solely to award scholarship grants to all company employees and their families who applied and who satisfied a selection criteria was not operated exclusively for exempt purposes. Although no collective bargaining agreement was involved, the Court noted that educational opportunities were generally limited to company employees and that the company was capable of exercising supervisory control over the program.

## 2. Funds Created by Government Employees

Organizations created by government employees or by members of a labor organization are usually perceived as a government or labor program even though this is frequently not the situation. The following hypothetical organization is a fairly typical representation of such organizations.

An organization is created by government employees for the purpose of providing relief to present and future fellow employees and retirees of a particular government agency in a particular region and their immediate families. Members of the board of directors and officers are employees of the government agency in the region and may also be members of the employee labor union. The directors, elected officers and committee members act exclusively for the organization rather than as representatives of the agency or the employee labor union. The organization clearly establishes that the employee disaster relief and emergency hardship program is not a program of the government agency or the union and that it will not discriminate in favor of higher paid employees, officials or key employees of the agency or of the union.

The organization described above is employee established, operated, controlled and funded. It is not an employee membership organization. It operates independently from the union and the agency. Such an organization is similar to the organizations described in Rev. Ruls. 55-406 and 56-403, *supra.*, and may be exempt under IRC 501(c)(3).

### 3. Employer Related Disaster Relief and Emergency Hardship Organizations

#### A. Description

Frequently organizations are established, controlled or funded by an employer to provide disaster relief or employee hardship benefits to employees (or retirees) and their dependents or spouses who are employed by a particular employer. Usually, benefits will be provided based on objective criteria related to an individual's inability to meet basic living necessities as a result of a natural or civil disaster or an individual's need for financial assistance as a result of an emergency hardship caused by (1) death in the family, (2) unusual medical expenses caused by severe illness or accident, (3) uninsured losses caused by fire, crime, flood or other disasters, (4) unusual expense for the care and training of a handicapped dependent, or (5) insupportable indebtedness occurring for reasons beyond the individual's control. Assistance may be provided in the form of grants or in the form of loans with low or no interest. There may be a maximum amount of grants or loans per eligible employee per year. The amount of the assistance is usually related to the extent of the need. Typically, aside from initial qualification, employment is not a factor in the awarding of grants or loans for disaster or emergency hardship assistance.

#### B. Applicable Exempt Organizations Law

Persons who are unable to meet basic necessities because of a disaster or emergency hardship are generally proper objects of charity. Nevertheless, a charitable organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Regs. 1.501(c)(3)-1(c)(1). Furthermore, an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests. Regs. 1.501(c)(3)-1(d)(1)(ii). Also Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), held that the presence of a single non-exempt purpose, if substantial in nature, will preclude exemption regardless of the number or importance of statutorily exempt purposes. Where private interests arise from an otherwise charitable activity, the private interests must be "incidental" in both a qualitative and quantitative sense. Such private benefit then would be seen as insubstantial. The term "qualitative" relates to the necessity to serve private interests in order to also accomplish a charitable purpose. The term "quantitative" relates to whether the private benefit is insubstantial when viewed in relation to the public benefit conferred by the activity.

For example, in Rev. Rul. 70-186, 1970-1 C.B. 128, an organization maintained the water quality of a lake that was open to the general public but this activity also benefited lake side property owners. The organization obtained funds from lake side property owners, from members of the community adjacent to the lake, and from the municipalities bordering the lake. The lake was used extensively by the public and contained community owned public beaches, launching ramps, and other recreational facilities of a public nature. The private benefit was qualitatively incidental since it would be impossible for the organization to accomplish its exempt purposes without also benefiting property owners. In addition, the benefit was quantitatively incidental since the private benefit to lake shore property owners was relatively small in comparison with the public benefit. For contrast, in Rev. Rul. 75-286, 1975-2 C.B. 210, an organization that undertook to beautify public areas in a city block limited to areas adjacent to property owned by its members who also supplied its financial support was found to be serving the private interests of its members to more than an insubstantial amount by enhancing the value of members' property rights even though the activity also promoted the general welfare of the community. In this case, although the private interest served was qualitatively incidental it was not quantitatively incidental considering the limited area served by which the public would benefit in comparison with the financial benefit afforded to the organization's members. Also important was that the financial support of and control over the organization flowed from its members who stood to gain financially from the organization's activities. These factors were further evidence that the public did not derive nearly as much benefit from the organization's activities as was derived by the members since the public did not support the organization in a financial or organizational manner.

### C. Applicable Gift Exclusion Law

IRC 102(c) provides that the exclusion from gross income otherwise permitted for the value of property acquired by gift does not apply to amounts transferred by or for an employer to, or for the benefit of, an employee. IRC 102(c) was intended to reduce the opportunity for employers to provide compensation in the form of excluded gifts. See S. Rep. No. 313, 99th Cong., 2d Sess. (1986), 1986-3 C.B. Vol. 3 at 47-54, which notes that the U.S. Supreme Court, in a case involving payments made in a context with business overtones, has defined excludable gifts as payments made out of detached and disinterested generosity and not in return for past or future services or from motives of anticipated benefit (Comm'r v. Duberstein, 363 U.S. 278 (1960)). Under this standard, the Court said, transfers made in connection with employment constitute gifts only in the extraordinary instance. Under Duberstein, the determination of whether property transferred from an employer to an employee (or otherwise transferred in a business context) constitutes a gift to the recipient is to be made on a case-by-case basis by an objective inquiry into the facts and circumstances. If the transferor's motive was the incentive of anticipated benefit, or if the payment was in return for services rendered

(whether or not the payor received an economic benefit from the payment), then the payment must be included in income by the recipient. See also H.R. Rep. No. 426, 99th Cong., 1st Sess. (1985), 1986-3 C.B. Vol. 2 at 103-107 to the same purpose. Thus, the IRC 102(c) amendment recognizes that there is a pattern of compensation when an employer makes gifts to employees except if otherwise permitted by statute or in the most exceptional circumstances.

#### D. Discussion

Employer related disaster relief and employee hardship programs accomplish at least two purposes. They provide relief to persons who are distressed or otherwise proper objects of charity. However, they also afford employers with a significant benefit and may further a purpose of providing additional compensation or other employment benefit. For example, such programs would be viewed as important recruitment incentives and would encourage the goodwill of employees toward the employer. They also serve to increase the likelihood that employees will be available for work. Such programs would also serve to provide benefits to employees in a manner essentially similar to an employee welfare benefit plan that provides sick, life, death, accident and employee assistance such as counseling for stress, drug abuse or legal problems. Even though an employee would have no right to funds from a disaster or emergency hardship relief fund, employees would be eligible for disaster and emergency hardship benefits provided they are employed by a particular employer upon the occurrence of a disaster or financial emergency and they are in need of such assistance. As such, the programs would operate as a safety net since financial relief would be assured. Moreover, employees of a particular employer that has an employer established and controlled or funded disaster relief benefit program would have an important advantage over other similarly situated victims of the disaster in having access to assistance. Thus, the presence of the equivalent of a benefits package, even if not availed of, would constitute a significant benefit derived from an employment relationship. Although this would be especially important for employees located in areas that experience fairly regular disasters such as hurricanes, tornados, floods or earthquakes, the presence of a fund dedicated to employees' welfare is a significant employment benefit in the same way that a life benefit provides protection and security whether or not used.

Employer related disaster relief and emergency hardship programs cannot be dismissed as merely providing an insubstantial benefit. Such programs are of real and substantial value to employees who are in need of assistance at a time when other avenues of assistance are not readily available or have been exhausted.

If a valuable benefit, such as funds in times of hardship or disaster, is conferred on an employer's employees through a private foundation controlled and funded by the employer, then the substantial nexus between the foundation and its employer dictates a finding that the payments were made "by or for the employer." The payments will then

not be eligible for treatment as excluded gifts pursuant to IRC 102(c) and will be included in employees' incomes. Because the payments would be part of employees' incomes, a reciprocal benefit flows to the employer in the form of services of the employees. In these circumstances, the private foundation is, in effect, providing benefits on behalf of the employer to its employees. Therefore, the private foundation is serving the private and commercial interests of its sponsoring employer. Serving the employer's private interest in this manner would amount to a substantial nonexempt purpose that disqualifies the foundation for exemption under IRC 501(c)(3).

Employer related disaster relief and emergency hardship programs of private foundations also further private or nonexempt purposes more than incidentally under a qualitative or quantitative analysis. From a qualitative aspect, an employer established and controlled or funded charity could very well provide emergency hardship or disaster relief benefits to an entire community rather than to a group of individuals limited to those who are its employees. Thus, it is not necessary to serve the private interests of the employer to accomplish charity. However, even if the qualitative analysis was satisfied where the group selected necessarily would serve the interests of an employer to some degree, the public benefit served must significantly outweigh the private or nonexempt purposes served under the quantitative analysis. The employer would have ensured a significant degree of loyalty from employees by assuring their financial security in times of extreme stress. Also, the employer's disaster relief and emergency hardship programs would serve to produce a more stable and productive work force by providing resources that would enable employees to be available for work. While there is some public benefit in ensuring that individuals are provided for in times of disaster or financial crisis, there is no assurance that selection of beneficiaries solely among employees of a particular employer serves the best interests of the public. The public interest may very well be better served by providing resources to persons who may be in much more dire conditions than persons who happen to be employed by a particular employer. Also, by imposing an employment related eligibility criteria, the general welfare of the public is placed at a clear disadvantage compared with the significant benefit afforded employees of the particular employer.

Conversely, under the incidental benefit analysis an employee funded and controlled relief program would under such facts and circumstances be found to serve a particular employer to which the program related only incidentally since the employees would not view the program as derived from an employer provided benefit.

#### E. Inurement

The benefit conferred on the employer by an employer related disaster relief and emergency hardship program that is employer established, funded or controlled also provides inurement to the controlling business enterprise associated with it. This

contravenes the requirements of IRC 501(c)(3) and IRC 170(c)(2)(B) which provide for the qualification for exemption and charitable contributions only if, in addition to other factors, "no part of the net earnings of [the organization] inures to the benefit of any private shareholder or individual."

Part III. Private Foundation Issues in Employer Related Disaster Relief and Emergency Hardship Organizations

1. General

Both an employer related disaster relief program and an emergency hardship program operated by a private foundation would generally be viewed as providing more than an incidental or tenuous benefit to the employer and, therefore, would be in conflict with the self-dealing, taxable expenditure and qualifying distribution provisions under IRC 4941, 4942 and 4945.

2. Applicable Law

A. IRC 4941 Self-Dealing

IRC 4941(d)(1) provides that the term "self-dealing" includes direct or indirect acts between a private foundation and disqualified persons. Self-dealing includes the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation. IRC 4941(d)(1)(E). However, if the benefit received by the disqualified person is incidental or tenuous, such benefit, by itself will not necessarily give rise to an act of self-dealing. Regs. 53.4941(d)-2(f)(2). As examples of incidental or tenuous benefit, the regulations offer an example of public recognition arising from a charitable gift of broad public benefit such as a private foundation making a grant to a public charity for use in a deteriorated area in which a disqualified person is located; the naming of a recreation center after a disqualified person; or the awarding of educational grants under an employer related program that satisfies IRC 501(c)(3), 170 and 4945(g)(1). For an example of the kind of scholarship program with an employment nexus that meets the above requirements, see Regs. 53.4945-4(b)(5) (Example 1).

Rev. Rul. 73-407, 1973-2 C.B. 383, held that the benefit to a disqualified person was incidental and tenuous where a private foundation conditioned a grant to a public charity on the change of the public charity's name to that of the disqualified person.

Based on the benefit provided to the employer, as previously discussed, employer related disaster relief and emergency hardship programs operated by a private foundation that is established, controlled or funded by an employer furthers the private interests of the employer. Such programs associated with employment accomplish recruitment and retention incentives and produce a more stable and productive work force. They afford

the employer more than mere public recognition. They cannot be dismissed as merely providing a minor or tenuous benefit. They offer a real and substantial benefit to the employer. Therefore, since the benefits to disqualified persons are not incidental or tenuous pursuant to Regs. 53.4941(d)-2(f)(2), grants distributed under employer related programs will result in acts of self-dealing within the meaning of IRC 4941(d)(1).

#### B. IRC 4945 Taxable Expenditure

Both an employer related disaster relief program and an emergency hardship program operated by a private foundation which significantly further the private interests of the employer will also be in conflict with the taxable expenditure provision under IRC 4945.

IRC 4945(d)(5) provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation for any purpose other than a [charitable] purpose specified in IRC 170(c)(2)(B).

#### C. IRC 4942 Qualifying Distributions

IRC 4942(g)(1)(A)(i) provides, in relevant part, that the term "qualifying distribution" means any amount paid to accomplish one or more [charitable] purposes described in IRC 170(c)(2)(B).

Where an employer related disaster relief or emergency hardship program significantly furthers the private interests of the employer, it will be in conflict with the qualifying distribution requirements in IRC 4942(g)(1)(A)(i).

### Part IV. Employer Related Public Charities

#### 1. Charitable Purposes and Gift Exclusion Considerations

Whether disaster relief and emergency hardship payments or in-kind assistance made by a charity to employees of the sponsoring corporation are charitable under IRC 501(c)(3) or excluded as a gift under IRC 102(a) can be handled in a consistent manner is discussed in this part.

The Code does not provide for the exclusion of disaster relief and emergency hardship payments from the broad scope of IRC 61. IRC 102(a) provides that gross income does not include gifts. However, IRC 102(c) limited IRC 102(a) by providing that IRC 102(a) shall not exclude from gross income any amount transferred "by or for an employer to, or for the benefit of, an employee."

Because grants made by a private foundation are not made directly by the employer, the question has arisen whether amounts transferred by an employer to a private foundation for employee assistance programs are "by or for the employer." In the context of a private foundation, where the employer is contributing more than two-thirds of the total support for the foundation, there is a substantial nexus between the private foundation and its corporate sponsor which dictates a finding that the payments were made "by or for the employer," thereby invoking IRC 102(c) and accordingly rendering IRC 102(a) inoperative. IRC 102(c) does not require that the payments be compensatory in nature, rather, it merely requires that the amount transferred be by or for the employer to, or for the benefit of, an employee.

The nexus between the employer and employee may be deemed broken if the disaster relief and emergency hardship payments are provided to the employees through a public charity and if certain other conditions are met. If these conditions are met, the payments will be deemed not to have been made "by or for the employer," thus rendering IRC 102(c) inoperative and allowing IRC 102(a) to serve as a means to exclude an otherwise includable fringe benefit from gross income.

Providing such grants to employees through a publicly funded charity that is not excessively controlled by the employer and which meets certain other conditions ensures that the charitable purpose is primarily being accomplished and the employer is receiving a benefit that is not more than insubstantial. The conditions are designed to ensure that employment is merely an initial qualifier for eligibility, that the ultimate recipients are not chosen based upon employment related factors, and that those responsible for selecting recipients are independent from the employer.

Under the conditions stated, employers will not be prohibited from all contact with the public charity. For example, employers may receive reports about how their funds are being used. They also may provide non-binding advice. They also may provide administrative services (free, at cost, or at fair market value) provided the public charity remains in charge of making decisions about its investments and charitable program.

Where the nexus between the employer and employee is deemed broken by providing assistance through a public charity, and if certain other conditions are met, an employer related disaster relief and emergency hardship program will not be deemed as overly serving the employer's private interests. Rather, the benefits received by the employees would be seen as falling outside any pattern of compensation. In these circumstances, providing assistance to needy or distressed employees would accomplish exclusively charitable purposes.

Disaster relief and emergency hardship assistance programs would then operate under principles similar to those established for employer-related scholarship and

educational loan programs described in Rev. Proc. 76-47, 1976-2 C.B. 670 and Rev. Proc. 80-39, 1980-2 C.B. 772, respectively. In those situations, a pattern of compensation and private benefit to the funding employer is deemed broken chiefly by having such programs satisfy conditions that make it unlikely that any particular employee or child of an employee of a particular employer to which the programs relate would obtain a scholarship or loan. Since it is not practical to establish such an “iffy” selection process for disaster relief and emergency hardship assistance programs, the use of a public charity and establishment of certain other conditions described below accomplishes the same result.

2. Conditions in Assessing Charitable Purpose and Gift Exclusion in Employer Related Disaster Relief and Emergency Hardship Assistance Public Charities

- a. The program is operated by a public charity rather than by any employer related private foundation.
- b. The organization is not excessively controlled by the employer.
- c. The organization is not funded by the employer in a manner which will cause it to be classified as a private foundation.
- d. The organization does not fulfill a legal obligation of the employer, such as a program that is part of a collective bargaining agreement or a program that is part of a written plan that provides life, sick, accident, supplemental unemployment compensation or similar benefits.
- e. The organization's program is intended to provide basic necessities to persons who have encountered financial hardship for reasons beyond their control and/or to provide temporary relief to meet the necessities of life of persons who are needy and distressed on account of a disaster.
- f. The organization's beneficiaries comprise a charitable class which is open-ended, of sufficient size and which is not organized or operated to benefit particular individuals.
- g. Other than as an initial qualifier, employment is not a relevant factor in the application or selection process, or in

the amount or type of assistance provided. For example, employee's position in the corporation, length of service, continued employment, etc.

- h. The organization establishes a committee to administer the program consisting of persons who aside from serving on the committee have no financial interest in the employer; or the committee consists of persons representing a broad spectrum of employees who understand that they are acting in a personal capacity as agents of the organization rather than as representatives of the employer.
- i. The organization establishes specific written criteria for the application, selection and disbursement of funds, including minimal information for immediate relief and more detailed information for more long term assistance. The selection process must be objective and non-discriminatory.
- j. The program is not used by the employer or the organization to recruit employees or to induce employees to continue their employment or otherwise to follow a course of action sought by the employer.
- k. The organization informs all employees of the corporation that disaster relief and emergency hardship funds are available, including the criteria for application and selection.
- l. The organization will accept voluntary contributions from employees or others, but it will not accept contributions earmarked for specific individuals.
- m. The organization will maintain records of the assistance granted as required by Rev. Rul. 56-304, *supra.*
- n. The organization providing disaster relief or emergency hardship benefits is not a membership organization.

### 3. Foundation Classification

The following discussion sets forth the rules, generally, that would be applicable to organizations that conduct employer-related disaster relief or emergency hardship programs that seek to obtain classification as other than private foundations, assuming they qualify as charitable organizations.

IRC 509(a) defines the term "private foundation" to exclude any domestic or foreign IRC 501(c)(3) organization which is described in paragraphs (1), (2), (3), or (4) of this section.

IRC 509(a)(2) provides that the term "private foundation" does not include an organization that normally receives more than one-third of its support from persons other than disqualified persons. IRC 4946 defines "disqualified person" as to include substantial contributors to the foundation. IRC 507(d)(2) defines the term "substantial contributor" as any person who contributes more than \$5,000 to a private foundation, if such amount is more than two percent of the total support received by the foundation.

IRC 509(a)(1) provides that the term "private foundation" does not include an organization described in section 170(b)(1)(A)(vi). Regs. 1.170A-9(e)(1) provides that a 170(b)(1)(A)(vi) organization is an organization which is referred to in IRC 170(c)(2) and which is "publicly supported". An organization is described in IRC 170(c)(2) generally, if it is created in the United States, is organized and operated exclusively for IRC 501(c)(3) purposes, no part of its earnings inures to benefit any private shareholder or individual, and it does not participate in legislative or political activities. An organization is "publicly supported" if it normally receives a substantial part of its support from direct or indirect contributions from the general public. "Publicly supported" organizations must receive support from direct or indirect contributions from the general public in the amount of at least thirty-three and one-third of total support or must meet a facts and circumstances test. Regs. 1.170A-9(e)(2) and (3). Regs. 1.170A-9(e)(6) defines support for purposes of the thirty-three and one-third support test as contributions by an individual, trust, or corporation only to the extent that such contributions by each individual, trust, or corporation does not exceed two percent of the organization's total support. The facts and circumstances test under Regs. 1.170A-9(e)(3) requires that at least ten percent of an organization's total support must be derived from governmental or public sources; however, significant support derived from one family would be a factor working against satisfaction of the facts and circumstances test for determining public support. Similarly, in the case of an employer-related program, significant support derived from one corporation would tend not to demonstrate public support under the facts and circumstances. Regs. 1.170A-9(e)(3)(iv).

IRC 509(d) provides that the term "support" includes (but is not limited to) gifts, grants, contributions, or membership fees. Under Regs. 1.509(a)-3(f)(1) the terms "gifts" and "contributions" have the same meaning as such terms have under IRC 170(c). Any payment of money or transfer of property without adequate consideration shall be considered a "gift" or "contribution". However, under Regs. 1.170A-9(e)(7) the term "support" does not include (a) any amounts received from an activity the conduct of which is substantially related to the furtherance of its charitable purpose or function (other than the production of income) or (b) contributions of services for which a deduction is not allowable.

#### 4. Conclusion

The benefits received by employees from a private foundation established by their employer that are made available only to employees of that employer are income to employees. However, the benefits will be deemed not made by or for the employer and therefore excludable from the employees' gross incomes provided the benefits are provided through a public charity and the public charity satisfies certain other conditions. These conditions ensure that the benefits are provided outside the pattern of employment and that the benefits do not represent compensation for services.