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# irs updates rules for donors and grantmakers

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The Internal Revenue Service has updated certain rules concerning transfers to nonprofit organizations that may be used and relied on by private foundations and sponsors of donor-advised funds ("DAFs") that must exercise expenditure responsibility and by donors to make sure that their contributions are eligible for the charitable income tax deduction. Summarized below are the steps that should be taken by donors and grantmakers, along with suggestions for memorializing this important due diligence.

## **Background**

Internal Revenue Code Section 170 allows charitable income tax deductions for contributions to organizations described in IRC § 170(c). Since the organization must qualify at the time of the contribution in order for the contribution to be deductible, the recipient charity must ensure that its purposes and activities continue to satisfy the qualification requirements for deductible contributions. The Treasury Regulations helpfully provide that, once an organization has received a favorable determination classifying it as an organization described in Section 509(a)(1) (certain classes of organizations, like churches and schools, as well as charities that receive substantial support from the general public), Section 509(a)(2) (organizations that receive substantial revenue relating to their charitable purpose, such as museums), or Section 509(a)(3) (supporting organizations), the treatment of contributions will not be affected by a subsequent revocation by the IRS of the organization's status until the date on which notice of the change is made to the public. Grantmaking private foundations may similarly rely on the classification of a recipient organization until public notice of the revocation of that classification.

## **Publication 78 and the Business Master File**

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nonprofit organizations



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A donor or grantor must first determine that the nonprofit organization to which the transfer will be made is a qualified charity. The most common method is to check IRS Publication 78, Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1986. The IRS no longer publishes a paper version of Publication 78, which is now available solely in electronic format on the IRS website at [www.irs.gov/app/pub-78](http://www.irs.gov/app/pub-78). The IRS has now made it clear that donors and grantmakers may also rely on the IRS Business Master File ("BMF"), also available on the IRS website.

Publication 78 generally indicates that an organization is classified as a private foundation or public charity. This information is important for donors, since lower deduction limits apply for contributions to private foundations. Publication 78 tells donors everything they need to know about the status of the recipient charity. Public charity status is also important for foundations and DAF sponsors, since they must exercise expenditure responsibility for grants to private foundations.

### Grants to Supporting Organizations

Private foundations and DAF sponsors also must determine whether a recipient organization classified as a public charity in Publication 78 is in fact a supporting organization described in IRC § 509(a)(3), since these grantmakers must exercise expenditure responsibility for grants to some supporting organizations as well. Unfortunately, Publication 78 does not separately identify supporting organizations – they are included in the general category of public charities. The BMF, however, does separately categorize supporting organizations. Note, however, that the expenditure responsibility requirements apply to some, but not all, supporting organizations. (Specifically, the requirements apply to Type 3 supporting organizations that are not functionally integrated with the supported charities.) Although the IRS has announced plans to modify "in early 2011" its coding system to specify the category of supporting organizations, that process is not yet complete. Until the BMF provides this information, it is suggested that, if the BMF indicates that the recipient charitable organization is classified as a supporting organization under IRC § 509(a)(3), it is important for the grantmaking foundation or DAF sponsor to determine the type of the supporting organization, since the grantmaker must exercise expenditure responsibility with respect to Type 3 non-functionally integrated supporting organizations.

### Continuing Qualification

Once the donor or grantor has determined the classification of the recipient charitable organization, it next must confirm that the recipient remains in good standing with the IRS. The 2006 Tax Act revokes the tax-exempt status of any nonprofit organization that is required to file an annual information return (i.e., Form 990, 990-N, 990-EZ, or 990-PF) but fails to do so for three or more consecutive years. That legislation also requires the government to publish a list of those organizations. The Internal Revenue Service recently published a list of approximately 275,000 organizations whose tax exemption has been revoked. The IRS will periodically update this publication. Deductible contributions and qualifying grants may generally be made to a charitable organization whose tax exemption has been revoked if the contribution or grant is made prior to the date of publication. However, if made after that date, the contribution or grant is no longer qualified. The revocation list appears on the IRS website, and future updates will be published either on the website or in the Internal Revenue Bulletin or by other means designed to put the public on notice of the change in organizational status.



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Similarly, if an organization is listed in Publication 78 or the BMF, and its status is not revoked automatically for failure to file returns but the IRS revokes the determination letter previously issued to that organization for other reasons, grants and contributions made to the organization by persons unaware of the change in status of the recipient organization are allowable if made before the date of public announcement that the organization ceases to qualify. These notifications are published by the IRS on its website, as well as in the Internal Revenue Bulletin.

These procedures may be found in Revenue Procedure 2011-33.

When making substantial contributions, donors and their advisors may wish to follow the best practice observed by grantmaking foundations to document their compliance with these rules by memorializing that Publication 78 (or the BMF) has been checked to confirm entity classification and that the IRS website was checked to confirm that the tax-exempt status of the recipient organization has not been revoked.