

DISASTER-RELIEF ASSISTANCE: THE REQUIREMENT OF NEED OR DISTRESS IN THE CONTEXT OF CHARITABLE GIFTS

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In the wake of the September 11th terrorist attacks against the United States, as well as the subsequent terrorist attacks involving anthrax, numerous charities¹ have made charitable gifts to the victims of the attacks, including to families of these victims. In making these charitable gifts, charities are faced with many difficult questions. One such question is whether a charity must document that the recipient of a charitable gift was “needy or distressed” at the time of receipt of the gift.

Federal tax rules historically have required that charities make a determination that recipients of charitable gifts are “needy or distressed” at the time the gifts are made.² However, on November 16, 2001, both the Internal Revenue Service (the “Service”), by issuing Notice 2001-78 (the “Notice”), and the United States Senate, by unanimously passing H.R. 2884, the Victims of Terrorism Tax Relief Act of 2001 (the “Victims Relief Act”), gave charities a “safe harbor” from satisfying the “needy or distressed” requirement when making charitable gifts to Victims.³ Specifically, if charitable gifts are made according to objective standards which are consistently applied, charities need not make an advance determination of the “need or distress” of Victims, although charities must maintain certain records when making the gifts.⁴ However, as noted below, this safe harbor does not apply beyond the September 11th disaster-relief and anthrax contexts and, therefore, charities must satisfy the “needy or distressed”

¹ As used in this memorandum, the term “charities” refers to organizations exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”), and classified as either public charities or private foundations within the meaning of Code section 509(a).

² An exception exists if no need is implied in the charity’s mission, e.g., merit scholarships.

³ As used in this memorandum, the term “Victims” shall have the same meaning as the term “Victims” in the Victims Relief Act, which is (i) persons killed, injured or wounded as a result of the September 11, 2001, terrorist attacks against the United States, (ii) persons killed, injured or wounded as a result of a terrorist attack involving anthrax occurring on or after September 11, 2001, and before January 1, 2002, and (iii) the families of those persons described in clauses (i) and (ii).

⁴ Pursuant to Revenue Ruling 56-304, 1956-2 C.B. 306, the Service continues to require that a charity making a grant to an individual maintain adequate records and case histories to show the name and address of each recipient of aid; the amount distributed to each; the purpose for which the aid was given; the manner in which recipient was selected and the relationship, if any, between the recipient and certain insiders of the charity, such as members, directors, officers and substantial contributors.

requirement when making charitable gifts to victims of other civil or natural disasters (e.g., to victims of a flood, hurricane, tornado, etc.).

**THE REQUIREMENT OF NEED OR DISTRESS
FOR PURPOSES OF THE SEPTEMBER 11TH
TERRORIST ATTACKS AND SUBSEQUENT
ANTHRAX ATTACKS.**

The Notice.

By issuing the Notice on November 16, 2001, the Service provided interim guidance to charities with respect to charitable gifts made “by reason of the death, injury or wounding of an individual incurred as a result of the September 11, 2001 terrorist attacks against the United States.” Specifically, in the absence of Congressional legislation, the Notice states that the Service will treat all gifts made by a charity to Victims as related to the charity’s exempt purpose so long as the gifts are made “in good faith using objective standards.” This guidance is effective for all gifts made before the earlier of (i) final legislative action addressing this issue, or (ii) December 31, 2002. As discussed in greater detail immediately below, on the same date (November 16, 2001), the Senate enacted legislation similar in scope, which if signed into law, will supersede the interim guidance provided in the Notice.

The Victims Relief Act.

In General.

The Victims Relief Act was passed in the House of Representatives on September 13, 2001, and in the Senate on November 16, 2001. The Senate Finance Committee made several amendments to the House-enacted version of the Victims Relief Act prior to its passage in the Senate, including the addition of section 103, entitled “Payments by Charitable Organizations Treated as Exempt Payments.” Section 103(a)(1) of the Victims Relief Act provides that payments made by [a charity to Victims will not endanger the charity’s federal tax exemption] if such payments are made “using an objective formula which is consistently applied. . . .”

Therefore, the statutory language of the Victims Relief Act means that charities need not perform advance assessments of the need or distress of Victims (whether financial or otherwise), so long as the gifts are made “using an objective formula which is consistently applied.” Stated differently, the Victims Relief Act provides a safe harbor for charities making charitable gifts to Victims. The legislative history of the Victims Relief Act further elaborates upon the Senate’s rationale for providing charities with this safe harbor: “[i]n light of the extraordinary distress caused by the attacks on the United States of September 11, 2001, the bill provides that organizations described in section 501(c)(3) that make payments by reason of the death, injury, or wounding of an individual incurred as a result of the September 11, 2001 attacks are not required to make a specific assessment of need for the payments to be related to

the purpose or function constituting the basis for the organization's exemption, provided that the organization uses an objective formula which is consistently applied, in making the payments."

The legislative history also describes several situations involving charitable gifts to families of firefighters killed in the line of duty. In this context, the legislative history states that a charity "could make a pro rata distribution to the families of firefighters killed in the attacks even though the specific financial needs of each family are not directly considered." Furthermore, if the charity were to base the amount of the charitable gifts "on the number of dependents of a charitable class of persons killed in the attacks" and were to apply this standard on a consistent basis, the charity would not have to take into account "the specific needs of each recipient."

In addition, the legislative history provides several examples of charitable gifts that the drafters of the Victims Relief Act believe are consistent with a charity operating exclusively for charitable purposes. These examples include (i) charitable grants that permit a surviving spouse with young children to remain at home with the children rather than being forced to enter the workplace; (ii) charitable grants to pay elementary and secondary school tuition (as well as higher education tuition) and that permit a child to remain in the same educational environment; and (iii) charitable grants to pay rent or mortgage payments for the principal residence of a Victim's family, or car loans for the family.

Section 103 of the Victims Relief Act applies to all charitable gifts to Victims made on or after September 11, 2001. Therefore, a charity making scholarship grants to the children of individuals killed in the September 11th terrorist attacks can continue to follow the guidance provided in the Victims Relief Act (e.g., and not perform needs assessments of scholarship recipients) even if scholarships are being granted out over a period of many years, unless later legislation provides otherwise.

Gifts from Private Foundations.

If a charity classified by the Service as a private foundation makes charitable gifts to Victims under the conditions set forth in section 103(a)(1) of the Victims Relief Act, the charitable gifts will not trigger self-dealing penalties under Code section 4941. The legislative history to the Victims Relief Act also states that the gifts will be treated as in furtherance of qualifying exempt purposes, and the private foundation making the gifts will be considered to meet the requirements of Code section 4945(g) regarding grants to individuals. This exception is significant because private foundations normally must apply to the Service for pre-approval of their grant procedures in advance of making any grants to individuals for travel, study or other similar purposes. In addition, the legislative history to the Victims Relief Act provides that if charitable gifts are made by a private foundation to employees and their family members of the employer that controls the foundation, the gift will be presumed to be made in furtherance of the foundation's charitable purposes, but only if (i) the class of beneficiaries of

the gifts is large or indefinite and (ii) the gift recipients are selected based on an objective determination of need by an independent committee of the private foundation, a majority of the members of which are persons other than persons who are in a position to exercise substantial influence over the affairs of the employer controlling the foundation.

**THE REQUIREMENT OF NEED OR DISTRESS
IN THE NON-SEPTEMBER 11TH DISASTER-
RELIEF AND ANTHRAX CONTEXTS.**

The legislative history to the Victims Relief Act discusses the provision of charitable gifts to the victims of civil or natural disasters other than the September 11th terrorist attacks and the subsequent anthrax attacks. In so doing, the legislative history confirms that the making of charitable gifts to victims of a civil or natural disaster “generally serves a public rather than a private interest,” and therefore furthers charitable purposes, “where the assistance benefits the community as a whole, or where the recipients otherwise lack the resources to meet their physical, mental and emotional needs.”⁵ However, the legislative history goes on to specifically confirm that a determination of the need or distress of recipients of charitable aid be documented: “[e]xcept as specifically provided in the bill with respect to certain payments made in response to the September 11, 2001, attacks, all such grants must be need-based, taking into account the family’s financial resources and their physical, mental and emotional well-being.”

Therefore, when making charitable gifts to victims of civil or natural disasters other than the September 11th terrorist attacks and the subsequent anthrax attacks, charities should follow the guidance set forth by the Service in a special publication entitled “Disaster Relief: Providing Assistance Through Charitable Organizations” made available on September 18, 2001, rather than the guidance offered in the Notice and the Victims Relief Act.

The IRS Disaster-Relief Guidelines provide that any charity making charitable gifts to the victims of civil or natural disasters must have in place a “needy or distressed test,” e.g., a set of criteria by which the charity can objectively make distributions to individuals who are financially or otherwise distressed. Specifically, any charity making charitable gifts must establish specific, written criteria for the application, selection and disbursement of funds and adequately document the basis upon which the funds are being provided. In addition, the charity must document that the recipient of the charitable gift was “needy or distressed” at the

⁵ The legislative history describes, as examples of appropriate kinds of disaster-relief assistance, cash grants to provide for food, clothing, housing, medical care, funeral costs, transportation, education and other needs.

time of receipt of the gift.⁶ In all cases, the charity's selection process must be objective and non-discriminatory.

In addition to setting forth the requirement that a charity making charitable gifts to the victims of civil or natural disasters must demonstrate the need or distress of the gift recipients, the IRS Disaster-Relief Guidelines specifically provide the following examples of "needy and distressed" persons:

- Persons impoverished as a result of low income and lack of resources;
- Persons temporarily in need of food or shelter when stranded, injured or lost because of fire, flood, accident or other disaster;
- Victims of a civil disturbance;
- Persons temporarily unable to be self-sufficient as a result of a sudden and severe personal or family crisis, such as victims of crimes of violence or physical abuse;
- Refugees or immigrants experiencing language, cultural or financial difficulties.

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If you would like further information on disaster-relief assistance and the requirement of need or distress in the context of charitable payments, please contact Victoria B. Bjorklund at (212) 455-2875 (v_bjorklund@stblaw.com), David A. Shevlin at (212) 455-3682 (d_shevlin@stblaw.com), Jennifer I. Goldberg at (212) 455-2287 (j_goldberg@stblaw.com), Jennifer L. Franklin at (212) 455-3597 (j_franklin@stblaw.com), or any other member of the Firm's Exempt Organizations Department.

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⁶ Presumably, a charity the mission of which is not needs-based (e.g., a merit scholarship program) would not need to satisfy this test.