Housekeeping Items

- Participants are on mute when they join the call.

- Staff will be monitoring the chat box, should you have a question during the presentation.

- We have reserved time at the end for questions.

- We will record and make the event available to view following the presentation.
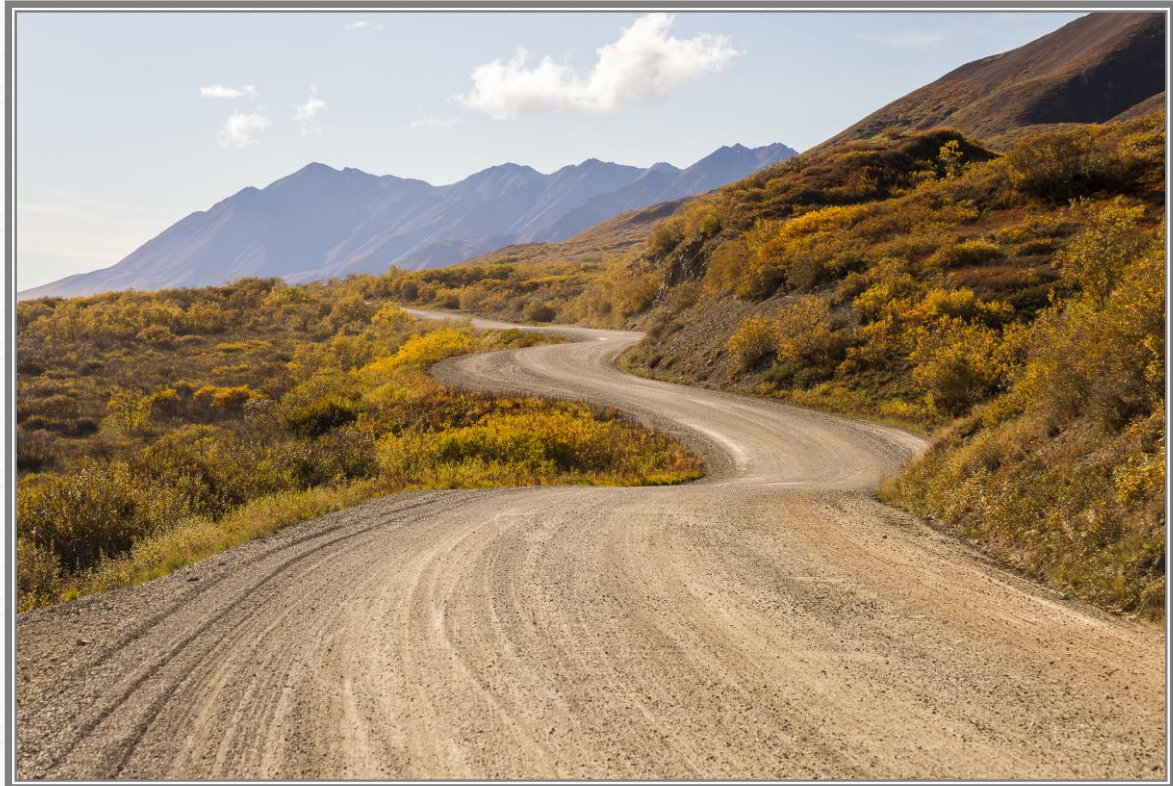
Today's Roadmap

- Overview of expenditure responsibility
  - CSA grantmaking requirements
  - What is a verified organization?
- IRS definition of charitable purpose
- Expenditure responsibility procedure
  - Common problematic grants
- Other grant roadblocks to avoid
  - Suggested best practices

What is Expenditure Responsibility?

According to the Council on Foundations *Legal Compendium*:

> *"Expenditure responsibility is the federally mandated procedure that a private foundation – and some public charities – must follow for any grant made to an organization that is not a public charity."*

A foundation can make a grant to any type of legitimate organization anywhere in the world (even to a casino in Monte Carlo) so long as the grant is **strictly for charitable purposes** and the foundation is prepared to take on the additional due-diligence requirements.

What is Expenditure Responsibility?

IRS definition:

Expenditure responsibility means that the foundation exerts all reasonable efforts and establishes adequate procedures:

1. To see that the grant is spent only for the purpose for which it is made,

2. To obtain full and complete reports from the grantee organization on how the funds are spent, and

3. To make full and detailed reports on the expenditures to the IRS.

(Source: IRS.gov)

Background

- Paycheck Protection Act – established new requirements for certain funds
  - **required public charities to use ER when making grants from donor advised funds to entities that are not public charities**
  - CSA funds - DAF/Field of Interest Fund Hybrid (?)

- Council on Foundations' **best-practice recommendation for public charities**: follow all requirements for private foundations
  - Law is unclear
  - Only way to ensure compliance is to follow best-practice recommendations
  - Other community foundations avoid this problem by restricting grants from affiliate funds to only 501(c)(3) charitable organizations

Responsibilities of the Foundation

- Prudent fund management
  - Investments, expenditures, compliance

- Due diligence in grantmaking
  - Grants from all funds only to verified 501(c)(3) organizations (CSAs excepted)
  - All grants must be made for "exclusively charitable purpose"
  - CSAs operate under SDCF's 501(c)(3) umbrella
  - Jeopardizing our 501(c)(3) charitable status puts CSA funds (and all other 1,000+ funds) at risk

- Fund agreement language
  - Gifts to SDCF are irrevocable, become property of SDCF
  - SDCF Board assumes "absolute and ultimate authority and control" over gifts
  - Charitable gifts = tax deduction for CSA donors

CSA Grantmaking

CSAs can (mostly) freely grant to:

- IRS-verified, tax-exempt organizations - 501(c)(3) organizations
- Churches
- Schools
- Recognized units of government

**Why? Trust that there is oversight built-in to these orgs and how they spend funds

Tax-exempt organizations that are not 501(c)(3)s or unverified organizations

- Can still make grants, just require additional oversight

What is a verified organization?

- Organizations are granted verification (determination) by the IRS

- The "determination" pertains to whether the organization may be exempt from federal taxes under section 501(c)(3) of the IRS code

- To qualify as a 501(c)(3), a nonprofit must be organized and operate *exclusively for one or more charitable purposes*

- These same guidelines are also used to determine if an individual grant has a charitable purpose

What is a verified organization?

"Not all 'non-profit' organizations are 'tax exempt', not all 'tax-exempt' entities are 'non-profit', not all 'tax-exempt entities' enjoy the benefit of tax-deductible contributions."

- Not just calling yourself a nonprofit organization
- Not just obtaining an EIN (a.k.a. Federal tax ID number)
  - Used to identify business entities – no special tax status conveyed
- Not just registration as a Nonprofit organization with the State of South Dakota
  - May entitle you to exemptions from state taxes
  - Does not exempt from federal taxes – does not convey 501(c) nonprofit status

What is a verified organization?

- Requires IRS Verification of tax-exempt status
  - File IRS form 1023 or 1023EZ
  - Identify the organization's overall charitable purpose
  - IRS assigns tax-exempt status (or not) – may be 501(c)(3) charity, or other type of 501(c) nonprofit (via Determination Letter)

IRS Determination Letter

INTERNAL REVENUE SERVICE
P. O. BOX 2508
CINCINNATI, OH 45201

DEPARTMENT OF THE TREASURY

Date: MAR 0 1 2018

Employer Identification Number:

DLN:

Contact Person:
  CUSTOMER SERVICE   ID# 31954
Contact Telephone Number:
  (877) 829-5500
Accounting Period Ending:
  December 31
Public Charity Status:
  170(b)(1)(A)(vi)
Form 990/990-EZ/990-N Required:
  Yes
Effective Date of Exemption:
  January 22, 2018
Contribution Deductibility:
  Yes
Addendum Applies:
  Yes

Dear Applicant:

We're pleased to tell you we determined you're exempt from federal income tax under Internal Revenue Code (IRC) Section 501(c)(3). Donors can deduct contributions they make to you under IRC Section 170. You're also qualified to receive tax deductible bequests, devises, transfers or gifts under Section 2055, 2106, or 2522. This letter could help resolve questions on your exempt status. Please keep it for your records.

Organizations exempt under IRC Section 501(c)(3) are further classified as either public charities or private foundations. We determined you're a public charity under the IRC Section listed at the top of this letter.

If we indicated at the top of this letter that you're required to file Form 990/990-EZ/990-N, our records show you're required to file an annual information return (Form 990 or Form 990-EZ) or electronic notice (Form 990-N, the e-Postcard). If you don't file a required return or notice for three consecutive years, your exempt status will be automatically revoked.

If we indicated at the top of this letter that an addendum applies, the enclosed addendum is an integral part of this letter.

For important information about your responsibilities as a tax-exempt organization, go to www.irs.gov/charities. Enter "4221-PC" in the search bar to view Publication 4221-PC, Compliance Guide for 501(c)(3) Public Charities, which describes your recordkeeping, reporting, and disclosure requirements.

DEPARTMENT OF THE TREASURY

Employer Identification Number:

DLN:

Contact Person:
  CUSTOMER SERVICE   ID# 31954
Contact Telephone Number:
  (877) 829-5500
Accounting Period Ending:
  December 31
Public Charity Status:
  170(b)(1)(A)(vi)
Form 990/990-EZ/990-N Required:
  Yes
Effective Date of Exemption:
  January 22, 2018
Contribution Deductibility:
  Yes
Addendum Applies:
  Yes

IRS Determination Letter

INTERNAL REVENUE SERVICE
P. O. BOX 2508
CINCINNATI, OH 45201

DEPARTMENT OF THE TREASURY

Date: MAR 0 1 2018

Employer Identification Number:

DLN:

Contact Person:
  CUSTOMER SERVICE   ID# 31954
Contact Telephone Number:
  (877) 829-5500
Accounting Period Ending:
  December 31
Public Charity Status:
  170(b)(1)(A)(vi)
Form 990/990-EZ/990-N Required:
  Yes
Effective Date of Exemption:
  January 22, 2018
Contribution Deductibility:
  Yes
Addendum Applies:
  Yes

Dear Applicant:

We're pleased to tell you we determined you're exempt from federal income tax under Internal Revenue Code (IRC) Section 501(c)(3). Donors can deduct contributions they make to you under IRC Section 170. You're also qualified to receive tax deductible bequests, devises, transfers or gifts under Section 2055, 2106, or 2522. This letter could help resolve questions on your exempt status. Please keep it for your records.

Organizations exempt under IRC Section 501(c)(3) are further classified as either public charities or private foundations. We determined you're a public charity under the IRC Section listed at the top of this letter.

If we indicated at the top of this letter that you're required to file Form 990/990-EZ/990-N, our records show you're required to file an annual information return (Form 990 or Form 990-EZ) or electronic notice (Form 990-N, the e-Postcard). If you don't file a required return or notice for three consecutive years, your exempt status will be automatically revoked.

If we indicated at the top of this letter that an addendum applies, the enclosed addendum is an integral part of this letter.

For important information about your responsibilities as a tax-exempt organization, go to www.irs.gov/charities. Enter "4221-PC" in the search bar to view Publication 4221-PC, Compliance Guide for 501(c)(3) Public Charities, which describes your recordkeeping, reporting, and disclosure requirements.

Dear Applicant:

We're pleased to tell you we determined you're exempt from federal income tax under Internal Revenue Code (IRC) Section 501(c)(3). Donors can deduct contributions they make to you under IRC Section 170. You're also qualified to receive tax deductible bequests, devises, transfers or gifts under Section 2055, 2106, or 2522. This letter could help resolve questions on your exempt status. Please keep it for your records.

Organizations exempt under IRC Section 501(c)(3) are further classified as either public charities or private foundations. We determined you're a public charity under the IRC Section listed at the top of this letter.

Other types of 501(c) Nonprofits

501(c)(4) – Social Welfare Orgs: Volunteer Fire Depts., Rotary Club, AARP, ACLU, NRA

501(c)(5) – Labor/Ag Unions: United Steelworkers, National Education Association

501(c)(6) – Trade Associations: Chamber of Commerce, Real Estate Board, Economic Dev. Corp

501(c)(7) – Country clubs/recreational clubs/fraternities & sororities

501(c)(10) – Fraternal orders: Shriners, Masons (basically, orgs operating under lodge system)

501(c)(13) – Cemeteries/cemetery companies

501(c)(19) – Veteran's groups: VFW, National Guard Association, American Legion, Aerie

Nonprofits, but not charitable: expenditure responsibility is required (if charitable purpose present)

Grants to Non-501(c)(3) Organizations

- Two main steps for CSAs and their grantees:
    1. Verify charitable purpose
    2. Utilize expenditure responsibility procedure

- Similar to the current SDCF expenditure responsibility process
    o What's changed? Potentially, a bit more investigation and documentation

What is a Charitable Purpose?

8 Categories of Charitable Purpose as defined by the IRS:

"The exempt purposes set forth in Internal Revenue Code section 501(c)(3) are *charitable*, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and the prevention of cruelty to children or animals. The term *charitable* is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency."

Charitable Purpose Infographic

WHAT IS CHARITABLE PURPOSE?

SOUTH DAKOTA COMMUNITY FOUNDATION

DEFINITION

Charitable purpose is what sets a 501(c)(3) organization apart from other types of nonprofits. In order to qualify for 501(c)(3) tax-exempt status, organizations must exist exclusively for one or more of the following charitable purposes, as defined by the IRS, and broken down below:

- Charitable (generally)
- Religious
- Educational
- Scientific
- Literary
- Testing for public safety
- Fostering amateur sports competition
- Preventing cruelty to children or animals

WHAT IS THE DIFFERENCE?

Nonprofit Organizations

Nonprofit status is a concept of state law.
Nonprofit corporation status is granted by the Secretary of State.
There are several kinds of nonprofits, not all are tax-exempt.

Charitable Organizations (501c3s)

Charitable organizations are a **type of nonprofit**.
Their *charitable purpose* sets them apart from other nonprofits.
Designated by the IRS through section 501(c)(3) of Int. Rev. Code.
Such organizations are tax-exempt.
Must meet the IRS definition of charitable to qualify.

WHAT IS CHARITABLE?

Religious

Two basic guidelines:
1. *Beliefs must be truly and sincerely held; and*
2. *Practices/rituals not illegal or contrary to public policy*
Examples: churches, ministries, missions, church-related charities, seminaries. Churches must also prove regularly scheduled service at a publicized time with regular attendance (no exclusively online churches).

Scientific

Better understood as scientific research. Project must be done in the public interest. Results must be made available to the public.
Examples: University studies published in medical journals. Also, economic modeling, agricultural and climate studies.

Testing for Public Safety

Not simply promoting public safety, activities must include testing. Primary work should be testing finished products, ingredients, or other components for use by the general public.
Examples: Underwriter's Laboratory or Consumer Reports, Inc.

Literary

A rare designation. Reserved for nonprofit bookstores or publishing activities. Must be able to demonstrate how operation furthers an *exclusively* charitable purpose.
Examples: religious publishing houses or college bookstores.

Fostering amateur sports competition

Also, a rare designation. Competition should be organized on *at least* a regional level, higher than truly amateur athletics such as Post baseball or YMCA swimming.
Examples: USA Cycling or USA Volleyball - competitions that feed into the Olympics.

Educational

One of the more commonly used categories, with a wide range of possibilities. Two requirements:
1. *Instruction or training of individuals for the purpose of improving or developing their capabilities; or*
2. *Instruction of the public on subjects useful to individuals and beneficial to the community.*
Examples: Primary or secondary school, college, tech school. Public discussion groups, forums, lectures, etc. Museums and zoos. Also, some alumni associations, children's sports leagues and nonprofit daycares.

Prevention of cruelty to animals or children

These organizations work for the general safety of children or animals. Note that many children's organizations will be considered educational.
Examples: ASPCA, World Wildlife Fund, humane societies, and endangered species habit groups. For children, APSAC, local Child Protection Teams, etc.

Charitable (Generally)

The catch-all category. Covers organizations that fulfill a charitable purpose but do not fit into one of the other categories. Further broken down into subcategories:
1. Relief of the poor, distressed or underprivileged
2. Advancement of religion
3. Advancement of education or science
4. Erecting/maintaining public buildings/monuments/works
5. Lessening the burdens of government
6. Lessening neighborhood tensions
7. Eliminating prejudice and discrimination
8. Defending human rights secured by law
9. Combatting community deterioration and juvenile delinquency
Examples: Community Foundations, St. Jude's, NAACP

Watch out for . . .

Examples of nonprofits that appear charitable but are not:

- Volunteer Fire Dept – 501(c)(4)
- Rotary Club – 501(c)(4)
- Labor and Ag Unions – 501(c)(5)
- Chamber of Commerce – 501(c)6
- Economic Dev. Corp. – 501(c)(6)
- Fraternities/Sororities - 501(c)(7)
- Country clubs – 501(c)7)
- Cemeteries – 501(c)(13)
- Legion, Post, etc. – 501(c)(19)

This sheet is a brief summary. For more in-depth guidance, please call SDCF at 1-800-888-1842.

Common Charitable Purpose Categories

Some categories are more commonly used than others:

- Religious
- Educational
- Prevention of cruelty to children or animal
- Charitable (generally)
  - Relief of poor, distressed or underprivileged
  - Advancement of religion
  - Advancement of education or science
  - Erecting or maintaining public buildings/monuments/works
  - Lessening the burdens of government
  - Lessening neighborhood tensions
  - Eliminating prejudice and discrimination
  - Defending human rights secured by law
  - Combatting community deterioration and juvenile delinquency

Expenditure Responsibility Process for CSAs

Step 1 – Grant Application
- Detailed description of the project and how funds will be used
- Follow-up questions and/or additional documentation may be needed*

Step 2 - Grant Acceptance Form
- Once grant is approved, grantee signs to agree to terms of grant, including ER process

Step 3 - Grant Expenditure Evaluation Form
- Returned to SDCF within 60 days after project is complete
- Itemized list of expenses – does it match up with original description of project, charitable purpose, and expenditures?

*In most cases the additional work required will be minimal

Common grants to watch out for . . .

- Volunteer Fire Departments

- American Legion/VFW/Aerie

- Chamber of Commerce

- Economic Development Corporation

- Membership/recreation orgs (country clubs/archery clubs/knitting clubs)

- Cemeteries

Other granting roadblocks to avoid

Private benefit prohibition
- Example: Art gallery organization consisting of several artists with purpose of showcasing and selling their own artwork.
  - IRS denied an exemption as it deemed the organization a vehicle for advancing the careers of the artists and promoting the sale of their works, even if there is an incidental educational benefit to the public.

Grants to individuals
- Most commonly seen in requests to improve privately-owned property
- Personal fundraisers

EIN Match-up
- Does the EIN match the ID of the organization requesting the grant?

Suggested Best Practices

- Call us first!

- Easiest to extend grants to 501(c)(3) and similar-type organizations

- Use a grant application as part of your granting process (we have a template you can use!)

- If you use your own grant application, make sure it asks the grantee to describe the project and how the money will be spent.

- If recommending a grant for an unverified organization, send the grant application with your distribution request, as this will cut out the step of us asking you for it.

- Do not announce grants/inform grantees until grants have been approved.

- Some grants that you've made before could be affected by this policy.

- Denials of grants may happen, but will be rare.

- Call us first!

Any questions?

Contact your local Development Officer
Beth Massa – West River and Rapid City area – bmassa@sdcommunityfoundation.org
Jamie Farmen – Central SD – jfarmen@sdcommunityfoundation.org
Pat Gallagher – NE SD – pgallagher@sdcommunityfoundation.org
Jeff Veltkamp – East River and Sioux Falls area – jveltkamp@sdcommunityfoundation.org

Contact Karly Winter
Operations & Compliance Manager
Pierre Office | (605) 224-1025
kwinter@sdcommunityfoundation.org

SOUTH DAKOTA COMMUNITY FOUNDATION

Thank you!

Karly Winter, J.D.
Operations & Compliance Manager
Pierre Office
(605) 224-1025
kwinter@sdcommunityfoundation.org