

H. EMERGENCY FUNDS AND DISASTER RELIEF ORGANIZATIONS *(Definite Class Problem)*

by
Carmen Pomares and Jay Rotz

1. Overview

Occasionally, the Service must determine the status of an organization formed for the purposes of aiding a victim or victims of a disaster, catastrophic illness, or other emergency. This article will discuss the exemption under IRC 501(c)(3) of emergency funds and disaster relief organizations, both terms used interchangeably. Briefly, and by way of background, some of the events which have given rise to the formation of these organizations will be discussed. The basis pursuant to which exemption is granted will follow, as well as general discussions on the issues raised by these organizations and particulars a specialist should be concerned with when reviewing an application.

2. Some of the Circumstances Giving Rise to the Formation of Emergency Funds and Disaster Relief Organizations

A variety of circumstances or events may precipitate the formation of an emergency fund. Generally, these organizations are formed in response to an unanticipated event and with a sense of urgency. For example, an organization may be formed in response to a natural disaster such as a flood or hurricane as in O.D. 345, 1 C.B. 151 (1919). An organization may likewise be formed in response to a human tragedy such as an accident or incident which captures national attention. Disaster relief organizations have also been formed in response to public concern for the dependents of those killed in the line of duty as in Rev. Rul. 55-406, 1955-1 C.B. 73; G.C.M. 32343 (7/9/62); G.C.M. 31772 (8/24/60), or while serving their country as in the armed forces. A disaster relief organization may be formed in response to a current event such as the relief of refugees, to secure the relief of prisoners as in G.C.M. 32482 (1/10/63), or hostages as in G.C.M. 36618 (3/10/76), or to help the victims of terrorist attacks and their families.

A disaster relief organization may also be formed in anticipation of a disaster. For example, a mining community may establish, in response to prior mining accidents, a fund to provide for the needs of victims of future disasters. Similarly, a community located in an area prone to flooding may decide to establish an ongoing fund to be activated only at times of natural disasters.

The formation of disaster relief organizations is not limited to domestic events or beneficiaries. In the same manner that a domestic charity may conduct some or all of its activities in a foreign country, or for the benefit of foreigners, an organization may be formed in response to, and for the purposes of, assisting the victims of a South American earthquake, Asian floods, or famine relief in Africa. See Rev. Rul. 71-460, 1971-2 C.B. 231, (a domestic corporation that conducts all or part of its charitable activities in a foreign country is not precluded from exemption under IRC 501(c)(3)); See also, Rev. Rul. 68-117, 1968-1 C.B. 251, a nonprofit organization formed and operated to assist needy families in developing countries may be exempt under IRC 501(c)(3).

In instances where a domestic exempt organization solicits funds for a specific disaster relief project of a foreign charitable organization, the domestic organization must exercise full control over the donated funds and exercise discretion as to the use of funds to insure they are used in a permissible manner. Rev. Rul. 66-79, 1966-1 C.B. 48, amplifying Rev. Rul. 63-252, 1963-2 C.B. 101.

3. The Exemption of Emergency Funds and Disaster Relief Organizations

The Income Tax Regulations provide that the term "charitable" is used in IRC 501(c)(3) in its generally accepted legal sense. 1.501(c)(3)-1(d)(2). "Charitable" does not only refer to the relief of poverty but also serves as a generic term and includes, among others, the advancement of education, the relief of the poor and distressed or of the underprivileged, and lessening of the burdens of government. The legal precedents determining what activities are in furtherance of charitable purposes are not limited to decisions under IRC 501(c)(3) but include the case law relating to charitable trusts and to the exemption statutes. Rev. Rul. 67-325, 1967-2 C.B. 113; Exempt Organizations Handbook, IRM 7751 (342).

A. Relief of the 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, as a result of the event giving rise to the formation of the organization, find themselves in a distressed condition. For example, trusts for the purpose of aiding victims of fires, earthquakes, drought, as well as for the humane treatment and release of hostages or prisoners have been recognized as charitable, IVA Scott, The Law of Trusts sec. 375.2 (4th ed. 1989); Bogert, Trusts and Trustees, sec. 379 (2nd ed. rev. 1977). It should be recalled that 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. See, e.g., Rev. Rul. 79-18, 1979-1 C.B. 194 (a nonprofit organization that provides specially designed housing to the elderly is operated exclusively for charitable purposes within the meaning of IRC 501(c)(3) as it relieves a form of distress the elderly may be susceptible to regardless of financial condition).

B. Another Basis for Exemption

The exemption under IRC 501(c)(3) of an emergency fund or disaster relief organization may be based on IRC 501(c)(3) purposes other than, or in addition to, a relief of the distressed rationale. Thus, an organization formed out of public concern for the dependents of armed forces personnel killed in action may provide for the education and health of dependents, both recognized charitable activities. Similarly, and in addition to its relief activities, an organization may undertake efforts aimed at preventing future like disasters by engaging in educational activities or supporting research aimed at the prevention of disasters.

Under certain circumstances, a disaster relief organization may be exempt under IRC 501(c)(3) as an organization which promotes patriotism. For example, an organization formed to provide active duty personnel with reading and entertaining material would be considered exempt as it would increase the morale of military personnel--an activity long considered within the purview of the law of charity. *See Scott* at sec. 374.3 (increasing preparations for war, increasing soldiers' professional competence, and supplying better food or literature are charitable activities).

The law of charity also contemplates assistance to the families of soldiers both during and after war. *Bogert* at sec. 378. While to an extent it can be said that these activities promote patriotism, a more accurate rationale for their exemption would be that an organization formed for the purposes of providing assistance to the families of soldiers relieves the distress caused by the soldier's participation in war. (see above).

Conceivably, a disaster relief organization may be exempt as an organization which lessens the burdens of government where the organization is able to establish that its activities are those a governmental unit considers to be its burdens, and that the activities of the organization actually lessens a governmental burden. Rev. Ruls. 85-1, 1985-1 C.B. 177 and 85-2, 1985-1 C.B. 178. Such an

organization would be one, for example, which undertakes relief and rescue efforts that governmental agencies traditionally would undertake. See, e.g., Rev. Rul. 74-361, 1974-2 C.B. 159 (nonprofit volunteer fire company that provides fire protection and ambulance and rescue services to a community is exempt under IRC 501(c)(3) as it serves to lessen the burdens of government).

4. Issues Raised by Emergency Funds and Disaster Relief Organizations

An application for exemption of an emergency fund or disaster relief organization will typically raise issues concerning the class of beneficiaries, in particular, whether the class of beneficiaries is limited. In addition, and as with other organizations seeking exemption, the applicant may be formed ostensibly for the benefit of distressed individuals but may serve to further the private interests of others.

A. Limited Class of Beneficiaries ("Indefiniteness" Requirement)

Emergency funds and disaster relief organizations are particularly susceptible to the problem of limited class as beneficiaries are often defined by the event which caused the formation of the organization in the first place. A summation of the general principles of law regarding class size and definition is helpful.

A basic principle of the law of charity is that a trust will not be upheld as charitable unless the trust is for the benefit of the community. Where a trust is created for the benefit of designated individuals, the trust will fail even where the purposes of the trust are to relieve the beneficiaries from poverty or distress, or to promote their education or health. A trust must be created for the accomplishment of purposes which are of benefit (or supposed benefit) to the community. Thus, a trust will fail if the class of persons to be benefitted is so narrow that the community has no interest in the performance of the trust. Where the class of potential recipients is sufficiently large, the fact that the number of persons who receive the benefit is small does not prevent the trust from being charitable. 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 sec. 375.

While a trust which provides for the distribution of charitable benefits to a single individual or very small group of definite persons may confer a negligible or non-existent community benefit, a trust may have as its object the improvement of

an identifiable class (e.g. residents of a single town or community) of individuals and not fail as charitable. In this latter case, the element of public interest may be supplied through the large size of the group from which ultimate beneficiaries will be chosen. Again, it is emphasized that the particular circumstances of each trust determine whether the size of the class of beneficiaries is such that there is a general public interest served by it or the trust serves the interests of a limited few beneficiaries. Bogert at sec. 363.

An emergency fund or disaster relief organization will avoid the problem of limited class if, in addition to meeting the other organizational requirements, its beneficiaries constitute a traditionally charitable class and are indefinite either by virtue of their large number, an analysis which is dependent on the facts and circumstances of each case, or by defining its class of beneficiaries in an "open-ended" manner.

For example, an organization formed for the purpose of assisting the victims of a hurricane or similar disaster of mass proportion may be less susceptible to being formed for the benefit of a limited class as the affected individuals most likely will encompass an entire community or other significant measure. O.D. 345, 1 C.B. 151 (1919).

Where an organization is formed in response to a disaster which injures or kills a group of individuals, it must be established that the organization is not formed for the benefit of a particular selected group. The class of beneficiaries must be such that not only is the organization formed to aid the victims of that disaster but others who may be similarly situated. Thus, if it is formed to aid the firemen and spectators injured as a result of the fire occurring on such date, then it is limited to that particular group of pre-selected individuals. But if the organization is formed to aid those injured or killed while undertaking fire fighting efforts, the class of beneficiaries is open-ended and will include victims of future fires. G.C.M. 32343 (7/9/62). So long as the class is open-ended, the presence of ascertainable beneficiaries does not per se preclude exemption under IRC 501(c)(3), for as stated in Bogert sec. 363 at page 29 "...many charitable trusts present the aspects of certain amount of definiteness as to present 'beneficiaries' but constant indefiniteness as to the future 'beneficiaries'." See, e.g., Rev. Rul. 56-403, 1956-2 C.B. 307 (the awarding of scholarships by a foundation solely to undergraduate members of a designated fraternity will not preclude it from exemption under IRC 501(c)(3) as the scholarships are not limited to present members of all chapters of the fraternity.).

B. Furthering the Private Interests of Others

A disaster relief 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. Regs. 1.501(c)(3)-1(d)(1)(ii).

A case in point is Wendy Parker Rehabilitation Foundation, Inc. v. Commissioner, T.C. Memo. 1986-348. This organization was established and operated by the Parker family, a member of which was in a comatose state. The certificate of incorporation stated the purposes of the organization as:

"To aid the victims of coma, resulting from motor vehicle accidents, stroke, drowning, and other related causes; to provide such coma victims, who are in various stages of rehabilitation and recovery, with funds and therapeutic equipment and devices used in conjunction with accepted coma recovery programs...to exchange and disseminate information concerning the care and treatment of coma victims in all stages of recovery." Supra, at 348.

While the record did not specify the number of recovering victims, in support of its application the organization had indicated "[t]hat there is no shortage of worthy needy recipients." Supra, at 348. However, the Tax Court found that in spite of the well-intended efforts of the organization to help coma patients, the organization by anticipating spending of 30% of its income for the benefit of Wendy Parker's rehabilitation was organized and operated for the benefit of the Parker family. Wendy's selection as a substantial recipient of funds conferred a benefit to the Parker family in the form of relief from the economic burden of caring for her.

Thus, even if an organization is created for a laudable and clearly charitable purpose (e.g. victims of industrial radiation accidents) the eligibility criteria, source of funding, or other circumstances surrounding its formation might indicate a private rather than a public purpose. For example, an emergency fund formed by fellow employees to assist their colleagues, victims of an accident or natural disaster, may be suggestive of a limited class problem where the assistance is solely or primarily for those employees as the class may be small and inherently closed given the one time nature of its creation and existence. A negative inference might be drawn where the organization is established and funded by the employer because it might be viewed as an indirect compensatory scheme. In this case, it is even more important to ensure that the class is large and potential beneficiaries indefinite.

It is possible that a disaster relief organization may be formed to serve the interests of the contributors. In G.C.M. 37385 (1/19/78), which recommended the reconsideration of the fund's exemption under IRC 501(c)(4), a fund was established by an exempt business league for the purpose of making distributions in the form of outright non-repayable grants to victims of a natural disaster. The fund, however, limited its beneficiaries to those disaster victims who had done business with one or more of the savings and loan associations who were the members of the business league contributing to the fund. Under these circumstances not only did the fund fail to operate for the benefit of the community but also, it served in a significant manner the business purposes of the contributors. See also, G.C.M. 37938 (4/20/79), involving an organization, seeking exemption under IRC 501(c)(6), formed to aid the victims of natural disasters. The organization at issue also limited its assistance to those qualified individuals with properties mortgaged to the contributing savings and loans associations.

C. Needs Test

Often, the assistance provided by a disaster relief organization is monetary as the organization seeks to relieve or cushion the financial hardships caused by the disaster. (It should be recalled that a finding of financial distress does not require the individual to be in a state of poverty or destitution. See Section C(1) above).

Where funds are distributed for purposes of relieving financial distress, it must be a distribution based on the demonstrated need of the individual. 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.

The existence of a needs test will ensure that funds are disbursed for the purposes of relieving an actual distressed situation and not as outright transfers of funds based solely on the individual's involvement in the event. As it is always the case with organizations which distribute funds to individuals, the emergency fund or disaster relief organization should, in addition to and distinct from the needs test, have in place a mechanism for maintaining adequate records of its disbursements. See Rev. Rul. 56-304, 1956-2 C.B. 306 and Section 5 below.

Of course, a disaster relief organization may, in addition to or solely, provide other than monetary assistance to distressed individuals. Where a disaster relief organization provides non-monetary assistance, such as counselling and other supportive services, evidence of financial need is not necessary.

It should be noted that as disaster relief organizations are formed in response to an unforeseen situation, it is possible to have individuals with short and long term needs where the beneficiaries of one are not necessarily entitled to other types of assistance. For example, following a devastating flood, a family may be in need of funds to meet immediate necessities. This same family, however, may not have the need (or meet the needs criteria established by the organization) for a low-interest building loan to repair their home as they are amply covered by insurance or are wealthy.

D. Use of an Established Exempt Organization for Relief Efforts

It is possible that an organization already recognized as exempt under IRC 501(c)(3) may undertake a disaster relief operation. In this case, it would appear that the exemption of the recognized entity will not be affected so long as the disaster relief activities are consistent with the exempt purposes of the organization and do not otherwise contravene IRC 501(c)(3). G.C.M. 36618 (3/10/76).

For example, an existing publicly supported organization may be approached by a group of individuals interested in raising or donating funds for a terminally ill patient or to be used for a transplant. While the earmarking of funds to the specific individual would not be consistent with the principles discussed in Section A above, the organization may determine that assisting the terminally ill is an activity for which there is a need in the community and which is consistent with its exempt purposes. In such a case, it is advisable for the organization to initiate the assistance project by adopting a board resolution to that effect, followed by an outline of procedures for application of assistance, and eligibility criteria. The organization could mention the project in any fund appeal but should not act as an agent for earmarked funds aimed at specific individuals.

E. Limited Duration

It is not unusual for an emergency fund 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. Thus, an organization of limited duration created to deal with a specific event would need to establish that its purposes and activities are not inconsistent with the indefiniteness requirement.

5. The Exemption of a Disaster Relief Organization

As with every application for exemption, it is necessary to make a detailed review of the formation of the organization as well as the manner of operation to ensure that all of the requirements for exemption under IRC 501(c)(3) are met. The following are some items to consider.

- a. The catalyst for the formation of the organization may reveal that the organization was established for the benefit of pre-selected individuals. 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.
- b. The naming of the organization after an individual victim may also be indicative of its purposes of serving the individual's interests or of pre-selection of a beneficiary.
- c. 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.
- d. The enabling or ancillary documents should contain a clear and precise statement addressing the purposes intended to be served as well as the intended beneficiaries of the organization's activities.
- e. The criteria according to which financial assistance will be distributed must be clearly stated.
- f. The organization's principals must be individuals who do not stand to benefit improperly from the organization's activities.
- g. Assistance to principals and their families does not per se preclude exemption so long as it is awarded on the same basis as that applied to the other recipients.
- h. The distribution of excess funds at the termination of the organization's existence in a manner consistent with the "indefiniteness" requirement should be established, especially in cases of limited duration.
- i. The general manner of operation should be examined e.g., the solicitation of funds, the involvement of the community in the organization, publicity concerning the availability of funds, etc.
- j. In instances where a domestic exempt organization solicits funds for a specific disaster relief project of a foreign charitable organization, the domestic organization must exercise full control over the donated funds and exercise

- discretion as to the use of funds to insure they are used in a permissible manner. Rev. Rul. 66-79, 1966-1 C.B. 48, amplifying Rev. Rul. 63-252, 1963-2 C.B. 101.
- k. The organization must have a mechanism to ensure that adequate records and case histories of its beneficiaries are maintained as suggested in Rev. Rul. 56-304, 1956-2 C.B. 306.
 - l. Where relevant, the use of caveats in the determination letter should be considered. This is especially so in order to emphasize the class of beneficiaries, the needs test, and the recordkeeping requirements of the organization.
 - m. Because of the urgent nature under which some emergency funds or disaster relief organizations are formed, the organization may be operating within a general framework and not have developed specific operational details at the time of application. Where this is the case, a determination may still be made based on the written representations of the organization. In such instances, it is advisable to incorporate these representations in the determination letter.
 - n. An organization may have commenced operations by the time it applies for exemption. In which case, the organization may be required to make changes in its method of operations for purposes of meeting the requirements of IRC 501(c)(3). Ordinarily, such changes may not be substantial enough to preclude retroactive exemption and deductibility. However, where an organization has made substantial improper distributions, prospective exemption and deductibility may be appropriate.
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