



Part 7. Rulings and Agreements

Chapter 27. Exempt Organizations Tax Manual

Section 19. Taxable Expenditures of Private Foundations

7.27.19 Taxable Expenditures of Private Foundations

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7.27.19.1 (02-22-1999)

Overview

1. IRC 4945 contains excise taxes to discourage private foundations from engaging in legislative and political activities, making grants to individuals without prior approval of the Internal Revenue Service (Service), making grants to organizations (other than public charities) without exercising adequate control and supervision over the use thereof, and providing grants for noncharitable purposes.
2. Guidance on IRC 4945 provided in this chapter is as follows:
 - A. IRM 7.27.19.1 provides an overview and historical background to IRC 4945.
 - B. IRM 7.27.19.2 outlines the basic framework of IRC 4945.
 - C. IRM 7.27.19.3 (concerning lobbying), IRM 7.27.19.4 (concerning politicking), IRM 7.27.19.5 (concerning grants to individuals), IRM 7.27.19.6 (concerning grants to organizations) and IRM 7.27.19.7 (concerning noncharitable expenditures) describe in detail five types of taxable expenditures as well as the requirements private foundations must meet in order for their expenditures to be not classified as taxable expenditures.
 - D. IRM 7.27.19.8, IRM 7.27.19.9, and IRM 7.27.19.10 describe in detail the sanctions, including first-tier and second-tier taxes, that may be imposed on private foundations and their managers for making taxable expenditures. These sections also describe in detail steps private foundations and their managers may take in order to avoid the imposition of sanctions.
 - E. IRM 7.27.19.11 provides a summary of relevant revenue rulings and revenue procedures that are applicable to IRC 4945.

7.27.19.1.1 (02-22-1999)

Background of IRC 4945

1. Congress enacted IRC 4945, part of the Tax Reform Act of 1969 (P.L. 91-172), in an effort to curb perceived abuses of private foundations. The perceived abuses included the following:
 - A. attempting to influence legislation;
 - B. engaging in political activities;
 - C. distributing funds to individuals for use in vacations and interludes between jobs;
 - D. subsidizing the preparation of materials furthering specific political viewpoints; and
 - E. failing to have adequate controls to ensure that the funds be used exclusively for exempt purposes.
2. IRC 4945 curbs abuses not covered by the other remedial provisions of Chapter 42. See background and general explanation of IRC 4945 in [General Explanation of the Tax Reform Act of 1969](#) (Blue Book), prepared by the Staff of the Joint Committee on Internal Revenue Taxation, December 3, 1970.

7.27.19.2 (02-22-1999)

Framework of IRC 4945

1. IRC 4945 was enacted, as discussed above, to deter private foundations from making inappropriate expenditures. Excise taxes are imposed on private foundations and their managers for expenditures that fall within the definitions of "taxable expenditures."
2. There are five categories of taxable expenditures. Taxable expenditures are amounts paid or incurred by private foundations:
 - A. to carry on propaganda, or otherwise attempt to influence legislation (IRC 4945(d)(1));
 - B. to influence the outcome of any specific public election, or to carry on a partisan voter registration drive (directly or indirectly) (IRC 4945(d)(2));
 - C. as a grant to an individual for travel, study, or other similar purposes, unless the grant meets certain requirements (IRC 4945(d)(3));
 - D. as a grant to an organization unless such organization is a public charity or unless the grantor private foundation exercises "expenditure responsibility" over the grant (IRC 4945(d)(4)); and
 - E. for any purpose other than one specified in IRC 170(c)(2)(B) (i.e., religious, charitable, scientific, literary, or educational purposes, to foster certain amateur sports or competitions, or for the prevention of cruelty to children or animals) (IRC 4945(d)(5)).
3. If a private foundation makes an expenditure that falls within the definition of any of these categories of taxable expenditures, IRC 4945(a)(1) imposes an excise tax that is to be paid by the private foundation. When the private foundation is subject to the IRC 4945(a)(1) tax, its managers may also be subject to initial excise taxes under IRC 4945(a)(2) if they know that an expenditure is a taxable expenditure and agree to make such taxable expenditure. However, this initial tax is not applicable if the agreement to make such taxable expenditure is not willful and is due to reasonable cause. The taxes described in IRC 4945(a)(1) and (a)(2) are known as "first-tier" taxes.

4. An additional excise tax of much greater severity is imposed under IRC 4945(b)(1) on the private foundation if it fails to correct the taxable expenditure within the taxable period. IRC 4945(b)(2) taxes are imposed on the foundation managers if they refuse to take action to correct the situation. The taxes described in IRC 4945(b)(1) and (b)(2) are known as "second tier" taxes. This two-tier tax structure is parallel to the tax sanctions imposed under IRC 4941 through 4944, although taxes on managers are only imposed under IRC 4941, 4944, and 4945. If the private foundation repeatedly or flagrantly violates IRC 4945, its status may be terminated by the Service. Such action may make the private foundation liable for termination taxes under IRC 507(c).
5. A private foundation exempt from federal income tax under IRC 501(c)(3) cannot, as a substantial part of its activities, carry on propaganda or otherwise attempt to influence legislation. The definition of substantiality is irrelevant for purposes of IRC 4945. Any amount spent or incurred by a private foundation in an attempt to influence legislation is a taxable expenditure under IRC 4945. A private foundation may also lose its exempt status if the legislative activity is substantial.
6. Private foundations are not permitted to make the IRC 501(h) election and be covered by the liberal lobbying expenditures tests under IRC 4911.

7.27.19.3 (02-22-1999)

Attempting to Influence Legislation (Lobbying)

1. IRC 4945(d)(1) provides that a taxable expenditure includes any amount paid or incurred by a private foundation to carry on propaganda or otherwise to attempt to influence legislation, i.e., lobbying. IRC 4945(e) defines two types of activities that constitute lobbying. They are:
 - A. "grassroots" lobbying (or indirect lobbying), and
 - B. direct lobbying.

7.27.19.3.1 (02-22-1999)

Grassroots Lobbying

1. Grassroots lobbying or indirect lobbying is communication that attempts to influence the opinion of the general public, or any segment thereof with respect to legislation. See IRC 4945(e)(1). The proscribed communications include propaganda and other materials affecting public opinion.
2. A communication is a grassroots communication if it:
 - A. refers to specific legislation;
 - B. reflects a view on such legislation; and
 - C. encourages the recipient of the communication to take action with respect to such legislation. See Regs. 53.4945-2(a)(1) and 56.4911-2(b)(2)(i). Also, 7.27.19.3.3(4), *infra*, for the definition of "specific legislation."
3. The specific rule for communications with members under IRC 4911 generally does not apply to private foundations. See Reg. 53.4945-2(a)(2).

7.27.19.3.2 (02-22-1999)

Direct Lobbying

1. Direct Lobbying involves the attempts to influence legislation through communications with members or employees of a legislative body and other officials who may participate in the formulation of legislation. These proscribed communications include attempts to influence the legislative process through the discussion with or presentation of materials to members of a legislative body. See Regs. 53.4945-2(a)(1) and 53.4911-2(b)(1).
2. A communication is a direct lobbying communication if it:
 - A. refers to specific legislation; and
 - B. reflects a view on such legislation. See Regs. 53.4945-2(a)(1) and 56.4911-2(b)(1)(ii). Also, see IRM 7.27.19.3.3(4), *infra*, for the definition of "specific legislation."

Example:

A private foundation that communicates its support for or opposition to a specific legislative proposal through an oral or written statement presented to a member of a legislative body is attempting to influence legislation within the meaning of IRC 4945(d)(1) and 4945(e)(2).

3. As with grassroots lobbying, a private foundation's communication with a member of a legislative body need not expressly support or oppose the legislative proposal under consideration in order for IRC 4945(d)(1) and 4945(e)(2) to apply.
 - For example, the presentation of a partisan analysis of a proposed bill to a member of the legislature may constitute an attempt to influence legislation.
4. As discussed above, Direct lobbying activities are not limited to communications or conversations with the members of a legislative body. Lobbying communications directed towards other governmental officials who participate in the formulation of legislation may be classified as direct lobbying but only if the principal purpose of the communication is to influence legislation. See Reg. 56.4911-2(b)(1)(B).

7.27.19.3.3 (02-22-1999)

Legislation Defined

1. "Legislation" is defined to include the following:
 - A. "Action" by the Congress, any State legislature, any local council or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure is within the definition of legislation.
 - B. "Actions" by Indian tribal governments may also be within the definition of legislation since Indian tribal governments are treated as state governments pursuant to IRC 7871. See Regs. 53.4945-2(a) and 56.4911-2(d)(1).
 - C. Proposed treaties. See Reg. 56.4911-2(d)(1)(i).
 - D. Foreign as well as domestic laws. See Rev. Rul. 73-440, 1973-2 C.B. 177.
 - E. Actions during a legislative confirmation process, considering nominees for certain non-elected government offices, such as judgeships and executive cabinet positions, may constitute attempts to influence legislation within the meaning of IRC 4945(d)(1). See Public Notice 88-76, 1988-2 C.B. 392.
2. The definition of "legislation" does not include action by executive, judicial, or administrative bodies such as school boards, housing authorities, sewer and water districts, zoning boards, and other similar federal, state, and local bodies whether elective or appointive. See Reg. 56.4911-2(d)(4).
3. The definition of "action" is limited to the introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions or similar items. See Reg. 56.4911-2(d)(2).
4. "Specific legislation," under Reg. 56.4911-2(d)(4)(ii), includes:
 - A. legislation that has already been introduced in a legislative body; and
 - B. a specific legislative proposal that an organization either supports or opposes.

5. As to a referendum, ballot initiative, constitutional amendment, or other measure that is placed on the ballot by petitions signed by a required number or percentage of voters, an item becomes "specific legislation" when the petition is first circulated among voters for signature.
6. The term "specific legislation" is illustrated by the following example.

Example:

A private foundation based in State A states in its newsletter that State Z has passed a bill and that State A should pass such a bill. The organization urges readers to write their legislators in favor of such a bill. No such bill has been introduced into the legislature of State A. However, the private foundation has cited to and given its view on a specific legislative proposal. Further, the private foundation has encouraged its readers to take action thereon. Consequently, the bill is considered a specific legislation.

7.27.19.3.4 (02-22-1999)**Exceptions to the Prohibition of Lobbying**

1. IRC 4945(e) and Reg. 53.4945-2(d) provide that certain activities specifically be excepted from the prohibition of attempting to influence legislation or lobbying. These permissible activities include the following:
 - A. providing nonpartisan analysis, study, or research to the general public or legislative officials;
 - B. examinations and discussions of broad social, economic, and similar problems;
 - C. providing technical advice or assistance to a requesting legislative body; and
 - D. self-defense communications — communications to a legislative body concerning a decision which might affect the private foundation's existence, powers and duties, tax exempt status, or deductibility of contributions.

7.27.19.3.5 (02-22-1999)**Nonpartisan Analysis, Study, or Research — Defined**

1. Probably the most important single exception permits private foundations to engage in any nonpartisan analysis, study, or research (which includes educational activities) and to distribute the results of these activities to the general public and legislative officials. See Reg. 53.4945-2(d)(1)(ii). The reason for the exception is that Congress did not want to discourage the educational activities of private foundations.
2. A nonpartisan analysis, study, or research is an objective and independent exposition of a particular subject matter. A study may advocate a particular position or viewpoint so long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion. However, where an analysis, study, or research merely presents unsupported opinion, distorted facts, inflammatory and disparaging terms, or conclusions based more on strong emotional feelings rather than objective factual evaluations, it is not educational and nonpartisan. See Reg. 53.4945-2(d)(1)(ii), and Rev. Proc. 86-43, 1986-2 C.B. 729.
3. A nonpartisan analysis, study, or research may also contain findings or recommendations supporting or opposing specific legislation or proposed legislation so long as it contains a sufficiently full and fair exposition of all relevant facts to enable individuals to form an independent opinion.

Example:

A private foundation's study that advocates the adoption of legislation and includes a discussion of only those facts supporting its position while omitting a discussion of all other relevant facts that do not support its position would not be considered nonpartisan and educational.

4. If a communication, analysis, study, or research reflects a view on specific legislation and directly encourages the recipient to take action with respect to such legislation, it is not nonpartisan and, thus, not described within this exception. See Reg. 53.4945-2(d)(1)(vi). A communication, analysis, and etc., directly encourages the recipient to take action if it does one or more of the following:
 - A. states that the recipient should contact a legislator or an employee of a legislative body, or should contact any other government official or employee who may participate in the formulation of legislation;
 - B. states the address, telephone number, or similar information of a legislator or an employee of a legislative body;
 - C. provides a petition, tear-off postcard or similar material for the recipient to communicate with a legislator, an employee of a legislative body, or with another government official or employee who may participate in the formulation of legislation; or
 - D. specifically identifies one or more legislators who will vote on the legislation as: opposing the communication's view with respect to the legislation; being undecided with respect to the legislation; being the recipient's representative in the legislature; or being a member of the legislative committee or being a member of the legislative or subcommittee that will consider the legislation. Naming the sponsor(s) of the legislation, however, is not deemed encouraging a recipient to take action. See Reg. 56.4911-2(b)(2)(iii)(A), (B), (C), and (D).
5. Subsequent use of nonpartisan study, analysis, etc. for lobbying by a private foundation or a public charity.
 - A. If a private foundation subsequently uses its nonpartisan analysis, study, or research for lobbying, the nonpartisan analysis, etc. may be deemed as a grass roots lobbying communication. See Regs. 53.4945-2(d)(1)(v)(A) and 56.4911-2(b)(v).
 - B. If a public charity uses a private foundation grant to finance a nonlobbying study, research, communication, etc. and the public charity subsequently uses it in lobbying, that private foundation's grant will not be deemed a lobbying expenditure. However, if that private foundation made that grant to that public charity primarily to be used for lobbying or knew (or should have known) that the public charity would use that grant for lobbying, then that grant would be a taxable expenditure. See Reg. 53.4945-2(d)(1)(v)(B). See also IRM 7.27.17.3.11, [infra](#).
6. The following are examples illustrating this exception. (For more examples, see Reg. 53.4945-2(d)(1)(vii).)
 - A. M, a private foundation, establishes a research project to collect information for the purpose of showing the dangers of the use of pesticides in raising crops. The information collected includes data with respect to proposed legislation, pending before several State legislatures, which would ban the use of pesticides. The project takes favorable positions on such legislation without producing a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion on the pros and cons of the use of pesticides. This project is not within the exception for nonpartisan analysis, study, or research because it is designed to present information merely on one side of the legislative controversy.
 - B. N, a private foundation, establishes a research project to collect information concerning the dangers of the use of pesticides in raising crops for the ostensible purpose of examining and reporting information as to the pros and cons of the use of pesticides in raising crops. The information is collected and distributed in the form of a published report which analyzes the effects and costs of the use and nonuse of various pesticides under various conditions on humans, animals, and crops. The report also presents the advantages, disadvantages, and economic cost of allowing the continued use of pesticides unabated, of controlling the use of pesticides, and of developing alternatives to pesticides. Even if the report sets forth conclusions that the disadvantages as a result of using pesticides are greater than the advantages of using pesticides and that prompt legislative regulation of the use of pesticides is needed, the project is within the exception for nonpartisan analysis, study or research since it is designed to present information on both sides of the legislative controversy and presents a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion.
 - C. O, a private foundation, establishes a research project to collect information on the presence or absence of disease in humans from eating food grown with pesticides and the presence or absence of disease in humans from eating food not grown with pesticides. As part of the research project, O hires a consultant who prepares a 'fact sheet' which calls for the curtailment of the use of pesticides and which addresses itself to the merits of several specific legislative proposals to curtail the use of pesticides in raising crops which are currently pending before State legislatures. The 'fact sheet' presents reports of experimental evidence tending to support its

conclusions but omits any reference to reports of experimental evidence tending to dispute its conclusions. O distributes 10,000 copies to citizens' groups. Expenditures by O in connection with this work of the consultant are not within the exception for nonpartisan analysis, study, or research.

- D. Organization Z researches, writes, prints and distributes a study on the use and effects of pesticide X. A bill is pending in the U.S. Senate to ban the use of pesticide X. Z's study leads to the conclusion that pesticide X is extremely harmful and that the bill pending in the U.S. Senate is an appropriate and much needed remedy to solve the problems caused by pesticide X. The study contains a sufficiently full and fair exposition of the pertinent facts, including known or potential advantages of the use of pesticide X, to enable the public or an individual to form an independent opinion or conclusion as to whether pesticides should be banned as provided in the pending bills. In its analysis of the pending bill, the study names certain undecided Senators on the Senate committee considering the bill. Although the study meets the three part test for determining whether a communication is a grass roots lobbying communication, the study is within the exception for nonpartisan analysis, study or research, because it does not directly encourage recipients of the communication to urge a legislator to oppose the bill.
- E. Assume the same facts as in Example (d), except that, after stating support for the pending bill, the study concludes: 'You should write to the undecided committee members to support this crucial bill.' The study is not within the exception for nonpartisan analysis, study or research because it directly encourages the recipients to urge a legislator to support a specific piece of legislation.
- F. Organization M pays for a bumper sticker that reads: 'STOP ABORTION: Vote NO on Prop. X!' M also pays for a 30-second television advertisement and a billboard that similarly advocate opposition to Prop. X. In light of the limited scope of the communications, none of the communications is within the exception for nonpartisan analysis, study or research. First, none of the communications rises to the level of analysis, study or research. Second, none of the communications is nonpartisan because none contains a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion. Thus, each communication is a lobbying communication.

7.27.19.3.5.1 (02-22-1999)

Presenting Results of Nonpartisan Analysis, Study, or Research

1. A private foundation may choose any suitable means, including oral and written presentations, to distribute the results of its nonpartisan analysis, study, or research. A private foundation, e.g., may distribute reprints of speeches, articles, and reports or present information through conferences, meetings, discussions, and public forums. Also, results may be made available through news media, including radio, television, newspapers, and the internet. See Reg. 53.4945-2(d)(1)(iv).
2. Occasionally a private foundation will choose to present the results of its nonpartisan analysis, study, or research through a series of programs or presentations. If the series as a whole is nonpartisan and educational, then individual presentation within the series will not result in a taxable expenditure even though it is not, by itself, nonpartisan and educational. Generally, all presentations occurring within a six-month period may qualify for treatment as a series. Nevertheless, all facts and circumstances of each particular situation will normally determine if a specific presentation is part of a series. See Reg. 53.4945-2(d)(1)(iii).

7.27.19.3.6 (02-22-1999)

Examinations and Discussions of Broad Social, Economic, and Similar Problems

1. Examinations and discussions of broad social, economic, and similar problems are neither direct lobbying communications nor grassroots lobbying communications. Thus, a private foundation's discussions or communications with members and employees of a legislative body and other officials involved in the formulation of legislation are not deemed direct lobbying so long as such discussions or communications do not address themselves to the merits of a specific legislation. See Regs. 53.4945-2(d)(4) and 56.4911-2(b)(1).
2. For example, a private foundation's discussion with members of the general public on problems that are being considered by Congress or other legislative bodies are not deemed grassroots lobbying only if the followings conditions are satisfied:
 - A. The discussions are not directly addressed to specific legislation being considered; and
 - B. The discussions do not directly encourage recipients of the communication to contact a legislator, an employee of a legislative body, or a government official or employee who may participate in the formulation of legislation. See Regs. 53.4945-2(d)(4) and 56.4911-2(b)(2).

7.27.19.3.7 (02-22-1999)

Providing Technical Advice or Assistance Legislative Bodies

1. Under IRC 4945(e)(2), a private foundation is not engaging in an attempt to influence legislation if it is providing technical advice or assistance to a governmental body, a governmental committee, or a subdivision of either of the foregoing. The technical advice or assistance must be made in response to a written request from such governmental body or committee. The request must be in the name of the governmental body or committee. See Regs. 53.4945-2(d)(2)(i) and (ii).
2. Similarly, the response, oral or written, from the private foundation must be made available to every member of the requesting governmental body. See Reg. 53.4945-2(d)(2)(i).
 - A. It may include opinions or recommendations with respect to a legislation, but only if they are specifically requested or are directly related to the information so requested.
 - B. Because such advice or assistance may be given only at the express request of a governmental body, committee or subdivision, such advice or assistance need not qualify as nonpartisan analysis, study or research. See Reg. 53.4945-2(d)(2)(ii).
3. The reason for the exception is that Congress did not want to deny itself and other legislative bodies the expertise of private foundations and their managers. Without this exception, they might be reluctant to provide their expertise to Congress, its committees and other legislative bodies to testify at the written request of these legislative bodies. See [General Explanation of the Tax Reform Act 1969](#) (Blue Book), at p. 49.
4. IRC 4945(e)(2) corresponds to the position taken in Rev. Rul. 70-449, 1970-2 C.B. 111. In that revenue ruling, a university described in IRC 501(c)(3) was requested by a Congressional committee to furnish a representative from its faculty to provide expert testimony on a pending legislation. The revenue ruling concluded that the university did not engage in prohibited legislative activity within the meaning of IRC 501(c)(3), since it was merely responding to an official request of a Congressional committee and it did not initiate the appearance.
5. The following are examples illustrating this exception. (For more examples, see Reg. 53.4945-2(d)(2)(iii).)
 - A. An official of the State Department, makes a written request in his official capacity for information from foundation Y relating to the economic development of country M and for the opinions of Y as to the proper position of the United States in pending negotiations with M concerning a proposed treaty involving a program of economic and technical aid to M. Y's furnishing of such information and opinions constitutes technical advice or assistance.
 - B. In response to a telephone inquiry from Senator X's staff, organization B sends Senator X a report concluding that the Senate should not advise and consent to the nomination of Z to serve as a Supreme Court Justice. Because the request was not in writing, and also because the request was not from the Senate itself or from a committee or subcommittee, B's report is not within the scope of the exception for responses to requests for technical advice. Accordingly, B's report is a lobbying communication unless the report is within the scope of the exception for nonpartisan analysis, study or research.
 - C. Assume the same facts as in example (b), except that B's report is sent in response to a written request that Senator X sends to B. The request from Senator X is a request from the Senator as an individual member of the Senate rather than from the Senate itself or from a committee or subcommittee. Accordingly, B's report is not within the scope of the exception for responses to requests for technical advice and is a lobbying communication unless the report is within the scope of the exception for nonpartisan analysis, study or research.
 - D. Assume the same facts as in example (c), except that B's report is sent in response to a written request from the Senate committee that is considering the nomination for an evaluation of the nominee's legal writings and a recommendation as to whether the candidate is or is not qualified to serve on the Supreme Court. The report is within the scope of the exception for responses to requests for technical advice and is not a lobbying communication.

7.27.19.3.8 (02-22-1999)**Decisions Affecting the Powers, Duties, etc. of a Private Foundation**

1. Under IRC 4945(e), a private foundation may appear or communicate with a legislative body concerning a decision of that body that might affect the existence of the foundation, its powers and duties, its tax exempt status, or the deductibility of contributions to it (the "self-defense" exception). See Reg. 53.4945-2(d)(3)(i). Hence, a private foundation may communicate with an entire legislative body, its committees or subcommittees, or individual legislators, members of their staffs or representatives of the executive branch who are involved in the legislative process to express its opposition or support to particular legislation (or legislative decisions) that affects the powers, etc., of the private foundation. However, the private foundation may not communicate with the general public with respect to that legislation. The private foundation may make expenditures in order to initiate legislation if such legislation concern matters which might affect its existence, powers and duties, tax-exempt status, or deductibility of contributions. Therefore, under this "self-defense" exception, funds expended for such purpose are not considered as attempting to influence legislation and not taxable expenditures.
2. The following examples illustrate this exception. (For more examples, see Reg. 53.4945-2(d)(3)(ii).)
 - A. A bill is being considered by Congress which would, if enacted, restrict the power of a private foundation to engage in transactions with certain related persons. Under the proposed bill a private foundation would lose its exemption from taxation if it engages in such transactions. W, a private foundation, writes to the congressional committee considering the bill, arguing that the enactment of such a bill would not be advisable, and subsequently appears before such committee to make its arguments. In addition, W requests that the congressional committee consider modification of the 2% de minimis rule of IRC 4943(c)(2)(C). Expenditures paid or incurred with respect to such submissions do not constitute taxable expenditures since they are made with respect to a possible decision of Congress which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation.
 - B. A State legislature is considering the annual appropriations bill. Z, a private foundation which had hitherto performed contract research for the State, appears before the appropriations committee in order to attempt to persuade the committee of the advisability of continuing the program. Expenditures paid or incurred with respect to such appearance are not made with respect to possible decisions of the State legislature which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation, but rather merely affect the scope of the private foundation's future activities.

7.27.19.3.9 (02-22-1999)**Situations that do not Constitute Attempts to Influence Legislation or Lobbying**

1. Three specific situations that do not constitute attempts to influence legislation are:
 - A. projects jointly funded by a private foundation and a governmental body;
 - B. grants to public charities not earmarked for lobbying; and
 - C. certain expenditures by program-related recipients.

7.27.19.3.10 (02-22-1999)**Jointly Funded Projects**

1. Reg. 53.4945-2(a)(3) provides that private foundations may make expenditures to fund discussions with members of legislative bodies or officials of governmental bodies provided:
 - A. the subject of such discussions is a program which is jointly funded by the foundation and the Government or is a new program which may be jointly funded by the foundation and the Government;
 - B. the discussions are undertaken for the purpose of exchanging data and information on the subject matter of the programs; and
 - C. such discussions are not undertaken by foundation managers in order to make any direct attempt to persuade governmental officials or employees to take particular positions on specific legislative issues other than such program.
2. Similarly, a private foundation may make expenditures to fund another organization's program merely upon the condition that the recipient obtain a matching support appropriation from a governmental body. See Reg. 53.4945-2(a)(3). Both of these activities would not constitute attempts to influence legislation and, hence, the expenditures made for such purpose would not be taxable expenditures.

7.27.19.3.11 (02-22-1999)**Grants to Public Charities**

1. A general support grant awarded by a private foundation to a public charity described in IRC 509(a)(1), (2), or (3) will not constitute a taxable expenditure described in IRC 4945(d)(1), whether or not the public charity has made a IRC 501(h) election, if the award is not earmarked for use to attempt to influence legislation. A grant is earmarked if the grant is given pursuant to a oral or written agreement that it will be used for specific purposes. See Reg. 53.4945-2(a)(6)(i). The following example illustrates this provision.

Example:

A private foundation, W, makes a general support grant to Z, a public charity described in IRC 509(a)(1). Z informs W that, as an insubstantial portion of its activities, it attempts to lobby the State legislature concerning changes in the mental health laws. W has not earmarked the grant to be used to attempt to influence any legislation. Even if Z subsequently uses the grant for legislative activities, the grant is not a taxable expenditure under IRC 4945(d)(1). For additional examples, see Reg. 53.4945-2(a)(7)(ii).

2. A specific project grant awarded by a private foundation to fund a specific project of a public charity is not a taxable expenditure as long as the —
 - A. grant is not earmarked (as defined in (1)) for use to attempt to influence legislation; and
 - B. amount of such grant, together with other grants by the same foundation for the same project for the same year, is less than or equal to the amount budgeted by the grantee organization for nonlobbying expenditures within the special project budget. See Regs. 53.4945-2(a)(6)(ii)(A) and (B).
3. If the grant is for more than one year, the aforementioned provision applies to each year of the grant with the amount of the grant measured by the amount actually disbursed by the private foundation in each year or divided equally between years, at the option of the grantor private foundation. The same method of measuring the annual amount must be used in all years of a grant. The following example illustrates this provision.

Example:

A private foundation, M, makes a specific project grant of \$150,000 to P, a public charity described in IRC 509(a)(1). In the grant application, P stated that the total budgeted cost of the project is \$200,000, and that of this amount \$20,000 is allocated to attempts to influence legislation related to the project. M relies on the budget figures provided by P in determining the amount P will spend on influencing legislation, and M has no reason to doubt the accuracy or reliability of P's budget figures. In making the grant, M did not earmark any of the funds from the grant to be used for attempts to influence legislation. M's grant of \$150,000 to P will not constitute a taxable expenditure under IRC 4945(d)(1) because M did not earmark any of the funds for attempts to influence legislation and because the amount of its grant (\$150,000) does not exceed the amount allocated to specific project activities that are not attempts to influence legislation (\$200,000-\$20,000 = \$180,000). For additional examples, see Reg. 53.4945-2(a)(7)(ii).

4. If a public charity loses its IRC 501(c)(3) status because of its attempts to influence legislation, a grant that has been made by a private foundation to that public charity will not be a taxable expenditure if certain conditions are satisfied.
 - A. The grant is a general support or specific project grant;

- B. The recipient organization had received a ruling or determination letter, or an advance ruling or determination letter that it is described in IRC 501(c)(3) and IRC 509(a);
- C. The private foundation has no knowledge that the Service has revoked the public charity's IRC 501(c)(3) status; and
- D. The private foundation does not control that public charity directly or indirectly. Regs. 53.4945-2(a)(7)(i), (A), (B), (C), and (D). See Reg. 53.4945-2(a)(7)(ii) for examples.

7.27.19.3.12 (02-22-1999)**Certain Expenditures by Program-Related Recipients**

1. Any amount paid or incurred by a recipient of a program-related investment (as defined in Reg. 53.4944-3 and IRM 7.27.18.4) in connection with an appearance before, or communication with, any legislative body with respect to legislation or proposed legislation of direct interest to such recipient shall not be attributed to the grantor foundation, if
 - A. the foundation does not earmark its funds to be used for any activities described in IRC 4945(d)(1); and
 - B. a deduction under IRC 162 is allowable to the recipient for such amount. See Reg. 53.4945-2(a)(4).

7.27.19.4 (02-22-1999)**Public Elections and Voter Registration Drives**

1. IRC 4945(d)(2) provides that a taxable expenditure includes any amount paid or incurred by a private foundation to influence the outcome of any specific election or to carry out, directly or indirectly, any voter registration. Nevertheless, a private foundation may make expenditures to fund voter registration drives, provided that these activities satisfy the requirement of IRC 4945(f).
2. Congress enacted IRC 4945(d)(2) in an effort to end involvements of private foundations in elections for public offices. Prior to the enactment, private foundations were attempting to influence the outcome of elections through voter registration drives carried on in limited or selected geographical areas that tended to favor particular candidates or political parties. Also, some private foundations engaged in election activity by making grants to organizations which then used the funds to support the election campaign of certain candidates for public office.

Note:

IRC 4955 also imposes excise taxes on expenditures made by IRC 501(c)(3) organizations in participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office (See IRM 7.25.3, Religious, Charitable, Educational, Etc., Organizations, Exempt Organizations Determinations Manual for a discussion of IRC 4955.). IRC 4955(e) provides that if an IRC 4955 tax or excess benefits tax under IRC 4958 is imposed with respect to a political expenditure made by a private foundation, that expenditure is not treated as a taxable expenditure for purposes of IRC 4945.

7.27.19.4.1 (02-22-1999)**Influencing the Outcome of a Specific Election**

1. A private foundation influences the outcome of a specific public election if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. See Reg. 53.4945-3(a)(2). The term "candidate for public" means an individual who offers himself or herself, or is proposed by others, as a contestant for an elective national, state, or local public office.
2. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but not limited to the following:
 - A. Publishing or distributing written or printed statements or making oral statements on behalf of or in opposition to a candidate;
 - B. Paying salaries or expenses of campaign workers; and
 - C. Conducting or paying the expenses of conducting a voter registration to the geographic area covered by the campaign.
3. The Service has held that certain activities, however, do not constitute participation or intervention. Specifically, attempting to influence the confirmation of federal judicial nominees is not deemed influencing the outcome of public election under IRC 4945(d)(2). See IRS Notice 88-76, 1988-2 C.B. 392. The rationale is that federal judges are not elected but appointed. Thus, attempts to influence the Senate's confirmation of a federal judge do not constitute influencing the outcome of a public election for purposes of IRC 501(c)(3), but instead constitute influencing legislation for purposes of IRC 501(c)(3), 4911, and 4945. For treatment under IRC 527, see IRM 7.27.11 concerning this topic in the Exempt Organizations Tax Manual. Also, see the following revenue rulings:
 - A. Rev. Rul. 72-512, 1972-2 C.B. 246, (holding that a university was not participating in political campaigns of when it offered a political science course that required students to participate in political campaigns of candidates of their choice);
 - B. Rev. Rul. 70-321, 1970-1 129 (holding that an organization formed to collect and collate campaign speeches, recorded interviews, comments, and other materials of a candidate for a historically important elective office for donation to a university or public library did not intervene in a political campaign).

7.27.19.4.2 (02-22-1999)**Permitted Voter Registration Drives**

1. Under IRC 4945(f), an exempt IRC 501(c)(3) organization may engage in nonpartisan voter registration activities provided that certain requirements are satisfied. If an organization meets these requirements, an amount paid or incurred by a private foundation is not considered a taxable expenditure even though the use of such amount is otherwise described in IRC 4945(d)(2). These requirements under IRC 4945(f) and Reg. 53.4945.3(b) are as follows:
 - A. The organization engaging in the voter registration activities must be described in IRC 501(c)(3) and exempt from taxation under IRC 501(a);
 - B. The voter registration activities must be nonpartisan. They must not be confined to one specific election period or carried out in fewer than 5 states;
 - C. The organization must spend substantially all its income directly for the active conduct of activities constituting the purpose or function for which it is organized and operated. This provision is satisfied if an organization spent at least 85% of its income for the active conduct of activities rather than to make grants to fund the activities of other organizations;
 - D. The organization must also receive at least 85% of its total support (other than gross investment income) from other exempt organizations, the general public, governmental units (described in IRC 170(c)(1)), or any combination of these sources. The organization may not receive more than 25% of such support from a single exempt organization, neither may the organization receive more than 50% of its total support from investment income (defined in IRC 509(e)); and
 - E. Contributions to an organization for voter registration activities must not be subject to conditions that they be used only in specified states, possessions of the United States, or political subdivisions or other areas of the foregoing, or the District of Columbia, or that they may be used only in one specified election period.
2. Thus, a private foundation may provide funds to an exempt IRC 501(c)(3) organization that is not a private foundation to engage in nonpartisan voter registration activities.
3. If a private foundation makes a grant to an organization described in IRC 4945(f), the grantor need not exercise expenditure responsibility with respect to that grant. Even if a grant to such an organization is earmarked for voter registration purposes generally, such a grant will not be treated as a taxable expenditure under IRC 4945(d)(2) or (4) as long as such earmarking is not in the order of the conditions discussed in IRM 7.27.19.4.2(1) e. above.

7.27.19.4.3 (02-22-1999)**85 Percent Support Test**

1. The 85% support test of IRC 4945(f)(4) is determined on an aggregate basis over a five-year period consisting of the current tax year and the immediately preceding four tax years. See Reg. 53.4945-3(b)(3)(i).
2. If an organization has completed at least one but less than four years, the support test is determined by aggregating all the support received during the current tax year and during each preceding taxable year. See Reg. 53.4945-3(b)(3)(iii).

7.27.19.4.4 (02-22-1999)

Advance Ruling Procedures

1. Reg. 53.4945-3(b)(4) and Rev. Proc. 2001-4, 2001-1 I.R.B. 121 (annually updated), provide that an eligible IRC 501(c)(3) organization may obtain an advance ruling or determination of its status under IRC 4945(f).
 - A. Such an advance ruling will be issued to an organization if it submits evidence establishing that it can reasonably be expected to meet the requirements of IRC 4945(f) for the initial tax year. The organization will then be treated as satisfying the requirements of an organization described in IRC 4945(f) for the first tax year.
 - B. An organization which, pursuant to an advance ruling, has been treated as satisfying the requirements of IRC 4945(f) (without the withdrawal of such treatment by notification during such year), but which ultimately fails to meet the IRC 4945(f) requirements for the taxable year, will lose its IRC 4945(f) status, from the first day of its next taxable year until such time as the organization meets the requirements under IRC 4945(f).
2. An organization's advance ruling is not effective beyond the end of its first tax year. Grantors and contributors may rely upon the advance ruling during the advance ruling year. Thus, grants made by a private foundation will not cause it to have a taxable expenditure. Such reliance becomes ineffective once notice of the change of status of the organization is made and publicized in the Internal Revenue Bulletin by the Service.
3. The grantors or contributors may not rely upon the advance ruling regardless of whether the Service had issued the notice of the change of status, if they —
 - A. were responsible for, or were aware of, the fact that the organization did not satisfy the requirements of IRC 4945(f) at the end of the taxable year for which the organization had obtained the advance ruling, or
 - B. acquired knowledge that the Service had notified the organization that it would lose its IRC 4945(f) determination. See Reg. 53.4945-3(b)(4).

7.27.19.4.5 (02-22-1999)

IRC 4945(d)(2) and Grants to Public Charities

1. A grant awarded by a private foundation to a public charity described in IRC 509(a)(1), (2), or (3) will not constitute a taxable expenditure described in IRC 4945(d)(2) (also IRC 4945(d)(5), see IRM 7.27.19.7.3, *infra*) if the award is not earmarked for use to influence the outcome of a specific election or carry on any voter registration drive and if there is no oral or written agreement whereby the private foundation may cause the recipient to engage in the aforementioned activities.
2. A grant is earmarked if the grant is given pursuant to a oral or written agreement that it will be used for specific purposes. See Reg. 53.4945-2(a)(5)(i) and (ii).

7.27.19.5 (02-22-1999)

IRC 4945(d)(3) Grants to Individuals

1. IRC 4945(d)(3) provides that a taxable expenditure includes any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or similar purposes by such individual, unless such grant satisfies the requirements of IRC 4945(g).
2. Congress enacted IRC 4945(d)(3) to curb the misuse of grants by some private foundations. Specifically, grants made to individuals purportedly for educational purposes were in fact used to serve private interests.

Example:

Some private foundations awarded grants to enable the grantees to take vacations abroad, to have paid interludes between jobs and to prepare materials furthering specific political viewpoints.

3. Simply stated, IRC 4945(d)(3) provides that all grants awarded by private foundations to individuals for travel, study, or similar purposes constitute taxable expenditures unless IRC 4945(g) applies to such grants. There are two underlying issues arising from IRC 4945(d)(3).
 - A. Whether the expenditure constitutes a "grant" within the meaning of IRC 4945(d)(3).
 - B. Whether the grant, if otherwise described in IRC 4945(d)(3), falls within IRC 4945(g).

7.27.19.5.1 (02-22-1999)

IRC 4945(d)(3) Grants Defined

1. The definition of grants, for purposes of IRC 4945(d)(3) include, but are not limited to, such expenditures as:
 - scholarships
 - fellowships
 - internships
 - prizes
 - awards
 - loans (for purposes described in IRC 170(c)(2)(B))
 - program-related investments
 - payments that support other exempt organizations (see 17.6)
2. A scholarship is defined to include any amount paid to, or for the benefit of, a graduate or undergraduate student for the pursuit of his/her studies. It is a "no-strings" educational grant, with no requirements of any substantial quid pro quo from the recipient such as any rendering of future services.
 - A. Fellowships and internships include similar payments for the benefit of an individual for the pursuit of his/her studies (see IRC 117 and regulations thereunder).
 - B. Prizes and awards include payments made to individuals in recognition for past educational, literary, artistic, or scientific accomplishments (see IRC 74(b)). If the prize or award was restricted to be used by the recipient for his/her studies, it would be a IRC 4945(d)(3) grant.
 - C. Long-term, low-interest loans made to students may be considered as grants described in IRC 4945(d)(3). See Rev. Rul. 77-434, 1977-2 C.B. 420.
3. The definition of grants do not ordinarily include:
 - A. salaries, or

B. other compensation paid to employees (defined under IRC 61); and

C. payments (including reimbursements for travel expenses such as transportation, board, and lodging) to persons for personal services in assisting a foundation in planning, evaluating or developing projects or areas of program activity by consulting, advising, or participating in conferences organized by the foundation. See Rev. Rul. 74-125, 1974-1 C.B. 327.

7.27.19.5.2 (02-22-1999)

Grants that are not IRC 4945(d)(3) Grants

1. Reg. 53.4945-4(a)(3)(i) provides that grants to individuals for purposes other than for travel, study or similar purposes are not taxable expenditures even if the requirements of IRC 4945(g) are not met.
 - For example, if a private foundation makes grants to indigent individuals to enable them to purchase furniture, such grants are not taxable expenditures within the meaning of IRC 4945(d)(3) even if the requirements of IRC 4945(g) are not met. However, such grants must still meet the requirements of IRC 4945(d)(5) and 170(c)(2)(B) in order not to be treated as taxable expenditures. See IRM 7.27.19.7.
2. A type of grant that does not fall within IRC 4945(d)(3) is a grant that does not finance any future activities of a grantee.
 - For example, in Rev. Rul. 75-393, 1975-2 C.B. 251, a private foundation made grants to individuals in recognition of past literary works. They were not made to finance any activities and no conditions were imposed on the manner in which it could be expended by the grantee. The Service concluded the grants were made not for study, travel or similar purpose, and, thus, do not fall within IRC 4945(d)(3).
3. Similar conclusions are reached in Rev. Rul. 77-380 (situation 1), 1977-2 C.B. 419 and Rev. Rul. 76-460, 1976-2 C.B. 371.
 - A. In the former, a private foundation made a grant each year to an individual whose work represented the best example of investigative reporting. Since the grant was awarded for recognition of past achievement and had no conditions for its use, it was not a IRC 4945(d)(3) grant and, therefore, not a taxable expenditure.
 - B. In the latter, a private foundation made grants to winners of a craft contest, and there were no restrictions for the use of the grants. The Service concluded that they were not grants for study or similar purpose and thus were not taxable expenditures.
4. However, in Rev. Rul. 76-461, 1976-2 C.B. 372, the Service concluded that a private foundation's grant to a high school senior for winning a science fair contest was a IRC 4945(d)(3) grant. Although the grant was made in recognition of a past achievement, the grant was conditioned upon the student attending college. Since the grant was intended to finance future educational activities of the grantee and conditions were imposed on the manner in which the award could be used, it was a grant described in IRC 4945(d)(3) and subject to the requirements thereof. See also situations 2 and 3 of Rev. Rul. 77-380, 1977-2 C.B. 419.

7.27.19.5.3 (02-22-1999)

Grants to Organizations Subsequently Awarded to Individuals

1. Private foundations occasionally make grants to other organizations that in turn award the grants to individuals for educational or similar purposes. These grants will not be considered as grants made to individuals (i.e., IRC 4945(d)(3) grants) if:
 - A. private foundations do not earmark the use of the grants for any named individuals; and
 - B. there are no agreements, written or oral, whereby the private foundations may cause the selection of the individual grantees by the grantee organizations. See Reg. 53.4945-4(a)(4)(i).
2. If a grantor private foundation has reason to believe that certain individuals would derive benefits from its grant to the grantee organization, such grant still would be considered as a grant to the grantee organization (and not to the individuals) so long as the grantee organization —
 - A. exercises control over the selection process; and
 - B. makes the selection completely independent of the grantor private foundation.

Example:

A private foundation provides grants to a high school for use as college scholarships. The high school's officials evaluate all of the student scholarship applications and advise the private foundation of the selected recipients. The private foundation has always approved the recipients selected thereof even though it retains final authority to select and determine the amounts of grants made to the recipients. Since the private foundation retains such authority, the selections of the recipients for the grants by the school officials are not made completely independently of the private foundation. Therefore, the grants are IRC 4945(d)(3) grants and the private foundation must seek advance approval pursuant to IRC 4945(g). See, IRM 7.27.19.5. Otherwise, the grants would be considered as taxable expenditures.

7.27.19.5.4 (02-22-1999)

Grants to Public Charities Subsequently Awarded to Individuals

1. When the intermediate grantee organizations are described in IRC 509(a)(1), (2) or (3), grants for use by individuals will not be considered as grants to those persons if the:
 - A. projects, for which the grants are used, are supervised by the public charities, and
 - B. public charities control the selection of the individual recipients. See Reg. 53.4945-4(a)(4)(ii).
2. However, the grantor private foundation may play a limited role in the selection process. Specifically, it may suggest candidates for the grants provided that there is an objective manifestation of control over the selection process by the grantee public charity.
3. Rev. Rul. 77-212, 1977-1 C.B. 356 illustrates the requirement that the public charity controls the selection process. In this revenue ruling, a private foundation provides grants to a vocational school (which is described in IRC 509(a)(1)) that are used to purchase tools for students. The students submit grant applications with lists of needed tools to the selection committee composed of representatives of the private foundation. The recipients are selected on ability and financial needs. The grants are made to the vocational school which then purchases the tools for the students. The Service concluded that the grants are deemed to be made to the individual students by the private foundation because the foundation retained the authority to select the grantee students. See Reg. 53.4945-4(b)(iv) for additional examples.

7.27.19.5.5 (02-22-1999)

Grants to Governmental Agencies Subsequently Awarded to Individuals

1. Where a private foundation makes a grant to a governmental agency described in IRC 170(c)(1) for use by an individual, the grant will not be subject to the requirements of IRC 4945(d)(3) and (g) if the governmental agency satisfies the Service in advance that its grant program:
 - A. furthers a charitable purpose described in IRC 170(c)(2)(B);
 - B. requires that the individual grantee submit to the governmental agency reports which must be done in a manner that satisfies the requirements of Reg. 53.4945-4(c)(3); and
 - C. requires that the governmental agency investigate jeopardized grants in a manner substantially similar to that described in the meaning Reg. 53.4945-4(c)(4). See Reg. 53.4945-4(a)(4)(iii); also, see IRM 7.27.19.5.8.1, [infra](#).
2. If these requirements are satisfied, these grants will not be subject to IRC 4945(d)(3) even if the grantor private foundation exercises considerable control over the selection of

individual grantees.

7.27.19.5.6 (02-22-1999) Renewal of Grants

1. A renewal of a grant is not treated as a new grant if:
 - A. the grantor has no information indicating that the original grant is being used for any purpose other than that for which it was made;
 - B. any reports due at the time of the renewal decision pursuant to the terms of the original grant have been furnished; and
 - C. any additional criteria and procedures for renewal are objective and nondiscriminatory.
2. Also, an extension of the period over which a grant is to be paid shall not itself be regarded as a grant or a renewal of a grant. See Reg. 53.4945-4(a)(3)(iii).

7.27.19.5.7 (02-22-1999) Advance Approval Under IRC 4945(g)

1. If a grant is described in IRC 4945(d)(3), it is a taxable expenditure unless it satisfies the requirements of IRC 4945(g). IRC 4945(g) provides, in effect, that any grant to an individual for travel, study, or similar purposes is not a taxable expenditure if it —
 - A. was awarded on an objective and nondiscriminatory basis,
 - B. was made pursuant to a procedure approved in advance by the Service,
 - C. constituted a scholarship or fellowship grant not includible as gross income pursuant to IRC 117(a) and was used to study at an educational organization described in IRC 170(B)(1)(a)(ii);
 - D. constituted a prize or award not includible as gross income pursuant to IRC 74(b)(1) and (2) (but disregarding (3)) and the recipient is selected from the general public, or
 - E. had the purpose of achieving a specific objective, producing a report or other similar product, or improving or enhancing a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee. See IRC 4945(g)(1), (2) and (3).
2. Hence, there are five requirements a IRC 4945(d)(3) grant must satisfy in order not to be treated as a taxable expenditure. Each of these requirements are discussed below.

7.27.19.5.7.1 (02-22-1999) Grants Made on an Objective and Nondiscriminatory Basis

1. In order for a foundation to establish that its grants to individuals are made on an objective and nondiscriminatory basis, the grants must be awarded in accordance with a program that is consistent with:
 - A. the existence of the private foundation's exempt status under IRC 501(c)(3);
 - B. the allowance of deductions to individuals under IRC 170 for contributions to the grantor private foundation; and
 - C. specific rules on establishing a pool of potential grantees, selection criteria, and the individuals making the selection.
2. The first and second requirements are self-explanatory. The third requirement is discussed below.

7.27.19.5.7.2 (02-22-1999) Pool of Potential Grantees

1. The pool of potential grantees must be selected on criteria reasonably related to the purposes of the grants and must be sufficiently broad to ensure that the giving of grants would be in furtherance of an IRC 170(c)(2)(B) purpose. Moreover, the pool must be sufficiently large to constitute a charitable class.
2. However, selection from a pool is not necessary, where taking into account the purposes of the grant, one or several persons are selected because they are exceptionally qualified to carry out these purposes; or it is otherwise evident that the selection is particularly calculated to accomplish the charitable purpose of the grant rather than to benefit particular persons or a particular class of persons. Hence, a private foundation may impose reasonable restrictions on the pool of potential grantees. See Reg. 53.4945-4(b)(2).

7.27.19.5.7.3 (02-22-1999) Selection Criteria

1. The criteria used in selecting grant recipients from the potential grantees should be related to the purpose of the grant. Thus, criteria for selecting scholarship recipients might include (but are not limited to) the following:
 - A. prior academic performance;
 - B. performance on tests designed to measure ability and aptitude for college work;
 - C. recommendations from instructors;
 - D. financial need; and
 - E. other facts and circumstances such as the conclusions which the selection committee might draw from a personal interview as to the individual's motivation, character, ability, and potential. Reg. 53.4945-4(b)(3).
2. For example, in Rev. Rul. 76-340, 1976-2 C.B. 370, selection criteria (in addition to academic standing, personal history, financial need) for a private foundation's scholarship program included the cost of the program the potential grantee proposes to pursue and whether he/she is likely to finance it with the private foundation's assistance. The Service permitted the use of these two criteria since it would assure that the private foundation's grants would support the completion of the grantee's educational program.
3. In contrast, the Service, in Rev. Rul. 85-175, 1985-2 C.B. 276, did not permit the use of criteria that give preference to family members and relatives of the contributors to the private foundation. Such criteria were in fact not in adherence to the objective and nondiscriminatory requirement. Moreover, if a substantial part of the private foundation's activities was the awarding of grants on this basis, the organization would jeopardize its exempt status under IRC 501(c)(3).

7.27.19.5.7.4 (02-22-1999) Persons Making Selections

1. The persons or group of persons who select the grantees should not be in a position to derive a private benefit, directly or indirectly from selection of grant recipient. See Reg. 53.4945-4(b)(4).

7.27.19.5.7.5 (02-22-1999) Grants Designed to Benefit a Specific Racial or Ethnic Minority Group

1. A private foundation may provide scholarships that are specifically geared toward racial or ethnic minorities and not be in violation of the objective and nondiscriminatory requirement of IRC 4945(g).
2. However, the scholarship program must satisfy the elements set out in Reg. 53.4945-4(b)(5), (Example 2). The facts in the example are as follows:

Example:

X company has organized a private foundation which, as its sole activity, provides 100 college scholarships per year to children of X company's employees. It also provides 20 college scholarships per year to a certain ethnic minority group. All members of this ethnic minority group (other than disqualified persons with respect to the private foundation) living in State Z are eligible to apply for these scholarships. It is estimated that at least 400 persons will be eligible to apply for these scholarships each year. Selection of the recipients are based on prior academic performance, performance on certain test designed to measure ability and aptitude for college works, and financial need. Under these circumstances, the operation of this scholarship program by the private foundation: (1) is consistent with the existence of the private foundation's exempt status under IRC 501(c)(3); (2) utilizes objective and nondiscriminatory criteria in selecting scholarship recipients from among the applicants; and (3) utilizes a selection committee which appears likely to make objective and nondiscriminatory selections of grantees.

7.27.19.5.8 (02-22-1999)**Grant Making Procedures — Advance Approval**

1. In addition to requiring that grants be awarded on an objective and nondiscriminatory basis, IRC 4945(g) requires that IRC 4945(d)(3) grants be awarded "pursuant to a procedure approved in advance" by the Service. To secure such approval, the private foundation must demonstrate the following:
 - A. Its grant procedure includes an objective and non-discriminatory selection process (as described in Section IRM 7.27.19.5.7);
 - B. Its grant procedure is reasonably calculated to result in performance by grantees of the activities intended to be financed; and
 - C. It will obtain reports from the grantees to determine whether they have performed the activities that the grants are intended to finance.
2. No single procedure or set of procedures is required and variant factual situations will determine what precautions are appropriate in each case. Reg. 53.4945-4(c)(1). Nevertheless, a procedure (or set of procedures) must include methods —
 - A. to supervise the use of scholarships, fellowships, and other types of IRC 4945(d)(3) grants,
 - B. to investigate "jeopardized" or "diverted" grants, and
 - C. to retain records of scholarships, fellowships and grants made. See Regs. 53.4945-4(c)(2), (3), (4) and (5).

7.27.19.5.8.1 (02-22-1999)**Supervision of Scholarships, Fellows and Other IRC 4945(d)(3) Grants**

1. Pertaining to scholarships and fellowships paid directly to the individual grantee, a grantor private foundation must make arrangements to receive a report of the courses taken at an educational institution and grades received by the grantee. The report must be verified by that educational institution and be obtained at least once per year. If no courses are taken (e.g., the grantee preparing a research paper, project, or doctoral thesis), the grantor private foundation must receive an annual progress report that has been approved by the faculty member supervising the grantee or an appropriate university official. A final report is also required upon the completion of the grantee's study at the educational institution. See Reg. 53.4945-4(c)(2).
2. With respect to other types of IRC 4945 (d)(3) grants, the private foundation must require an annual report on the use of the funds and the progress made by the grantee toward achieving the purposes for which the grant was made. A final report describing the grantee's accomplishments and accounting for the funds received is also required upon completion of the project. See Reg. 53.4945-4(c)(3).

7.27.19.5.8.2 (02-22-1999)**Investigation of Jeopardized or Diverted Grants**

1. A grantor private foundation must ensure that its grantees do not use the grants for purposes other than the original exempt purposes. Where a private foundation has information indicating that all or any part of a permitted IRC 4945(g) grant is not being used in furtherance of grant purposes, it is under a duty to investigate. Failure to investigate and correct such abuse may result in the grants becoming taxable expenditures. While conducting the investigation, the private foundation must withhold further payments of the grant to the extent possible until any delinquent reports have been submitted. See Reg. 53.4945-4(c)(4)(i).
2. Where the grantor private foundation determines that the grantee has used all or part of a grant for improper purposes and the grantee has not previously diverted grant funds, that grant will not be a taxable expenditure because of the diversion, provided the private foundation complies with two conditions.
 - a. It takes all reasonable and appropriate steps either to recover the grant funds or to ensure the restoration of the diverted funds and the dedication of other grant funds held by the grantee to the proper grant purposes; and
 - b. It withholds any further payments to the grantee after it becomes aware that a diversion may have taken place until it receives the grantee's assurances that future diversions will not occur. Further, it requires the grantee to take extraordinary precaution to prevent future diversions from occurring.
3. If the private foundation fails to comply with the first condition (paragraph 1., above), the amount of the taxable expenditure shall be the amount of the diversion plus the amount of any further payments to the same grantee. If the private foundation complies with condition paragraph 1. but not with paragraph 2., the amount of the taxable expenditure shall be the amount of such further payments. See Reg. 53.4945-4(c)(4)(ii).
4. If the grantee has previously diverted funds received from the grantor private foundation and it determines that all or part of the grant has been used for improper purposes, the grant will not be a taxable expenditure by reason of such diversion, provided the private foundation complies with two conditions. These two conditions are identical to that described in paragraph (2)1. and (2)2. above, except the following:
 - the private foundation may resume further payments only if the misappropriated or diverted grant funds are recovered or restored rather than merely receiving assurance that future diversions will not occur. See Reg. 53.4945-4(c)(4)(iii).
5. The phrase "all reasonable and appropriate steps", in paragraph (3) and (4) above, includes legal action where appropriate. Legal action is not necessary if it would in all probability not result in satisfaction on execution of a judgement.

7.27.19.5.8.3 (02-22-1999)**Retention of Records**

1. Every private foundation making grants to individuals for purposes described in IRC 4945(d)(3) must retain certain records with respect to such grants. These records must include:
 - A. information used to evaluate the qualifications of potential grantees;
 - B. identification of the grantees (including any relationship of any grantee to the private foundation), the amount and purpose of each grant; and
 - C. all grantee reports and other follow-up data obtained in administering the private foundation's grant program. See Reg. 53.4945-4(c)(6).

7.27.19.5.8.4 (02-22-1999)**Submission of Request for Approval of Grant-Making Procedures**

1. The request for advance approval of grant-making procedures must fully describe the private foundation's grant procedure (i.e., a system of standards, processing procedures, etc.) for awarding grants and for ascertaining that such grants are used for the proper purposes. The request may be submitted to the appropriate Area Office or to Director, Rulings and Agreements. See Reg. 53.4945-4(d)(2) and Rev. Proc. 2001-4, 2001-1 I.R.B. 121 (annually updated).
 - A. In *John Q. Shunk Ass'n. Inc. v. United States*, 626 F. Supp. 564 (E.D. Ohio 1985), the court held that advance approval under IRC 4945(g) is a mandatory, substantive requirement. See also *German Society of Maryland, Inc. v. Commissioner*, 80 T.C. 741 (1983).
 - B. However, taxes for failure to acquire advance approval of the service may be abated under IRC 4962. See IRM 7.27.19.9.6., [infra](#).
2. The request must contain the following:
 - A. A statement describing the selection process;
 - B. A description of the terms and conditions under which the foundation ordinarily makes such grants, which is sufficient to enable the Service to determine whether the grants awarded under such procedures would meet the requirements of IRC 4945(g)(1), (2), or (3);
 - C. A detailed description of the private foundation's procedure for exercising supervision over grants; and
 - D. A description of the foundation's procedures for review of grantee reports, for investigation where diversion of grant funds from their proper purposes is indicated, and for recovery of diverted grant funds, as described in IRM 7.27.19.5.8.2.
3. The approval procedure does not contemplate a series of separate approvals of particular grant programs. Once a private foundation grant procedures are approved by the Service, such grant-making procedures apply to a new grant program so long as the procedures do not materially change. See Reg. 53.4945-4(d)(1).
4. If a private foundation submits a proper request for approval of its grant-making procedures and the Service does not notify it within 45 days that the procedures are not acceptable, then the procedures shall be considered as approved from the date of submission until receipt of actual notice that such procedures are not acceptable. Any grants made thereunder will not be taxable expenditures. If a grant is made to an individual after the Service notifies the private foundation that its procedures are disapproved, the grant is a taxable expenditure. See Reg. 53.4945-4(d)(3).
 - A. In Rev. Rul. 81-46, 1981-1 C.B. 514, a private foundation had not received a reply to a request for approval of its grant-making procedures within 45 days of its submission and, thereafter, awarded several installment grants. Prior to the completion of grant payments, the Service notified the private foundation that its grant-making procedures was disapproved. Nevertheless, the Service held that the remaining payments of the installment grants to be made would not be taxable expenditures since the private foundation was already obligated to make them. However, any renewals of grants awarded during the period would be taxable expenditures since the renewal would be discretionary.
5. A private foundation may request an approval of its grant procedures with its submission of Form 1023, Application for Recognition of Exemption under IRC 501(c)(3). A full and complete disclosure of its grant-making procedures and information required by Reg. 53.4945-4(d)(1) must be submitted in conjunction with the application. The Service has 45 days, as in a separate request situation, to rule on the procedures. Approval of the private foundation's exemption application does not in itself constitute approval of the organization's grant procedures unless the exemption letter so provides.
 - A. In Rev. Rul. 86-77, 1986-1 C.B. 334, the 45-day rule was applied and no taxable expenditures were found in a situation where the private foundation's exemption application did not specifically request advance approval but provided a full and complete disclosure of its grant making procedures.

7.27.19.5.8.5 (02-22-1999)

Employer Related Scholarship Programs and Loan Programs

1. Many private companies have established private foundations to fund scholarship programs for employees and/or their children. In such situation, the employee educational grants appear to be compensation, and the educational grants to the children of the employees appear to be compensation or provide an employment incentive to the employee-parents. Therefore, grants made by the private foundations pursuant to these employer-related scholarship programs are not scholarships or fellowship grants subject to IRC 117(a), and are taxable expenditures pursuant to IRC 4945(d)(3). Nonetheless, if a private foundation satisfies seven conditions and a percentage test outlined in Rev. Proc. 76-47, 1976-2 C.B. 670, and further clarified by Rev. Proc. 85-51, 1985-2 C.B. 717, the Service will assume the contrary. These requirements are summarized below as follows (for further detail, see the cited revenue procedures):
 - A. **Inducement:** the employer-related scholarship program must not be used by the employer and the private foundation as an inducement to recruit or retain employees to continue their employment;
 - B. **Selection Committee:** must be comprised of individuals totally independent and separate from the private foundation and the employer. These individuals may not be employees or former employees and should be knowledgeable in the educational field;
 - C. **Eligibility Requirements:** must be related to the purpose of the grant program. Potential recipients must be able to meet the admission requirements of and attend an educational institution. If a minimum period of employment is required to qualify for such scholarships, this period may not exceed three years;
 - D. **Objective Standard:** selection must be based upon objective standards that are unrelated to employment of the recipient or to the employer's line of business;
 - E. **Employment:** once awarded, a scholarship may not be terminated if the recipient (or his/her parents) is no longer employed with that employer;
 - F. **Course of Study:** the courses of study for which the scholarship are available must not be limited to those that would benefit the employer or private foundation;
 - G. **Other Requirements:** the employer-related scholarship program must meet all other requirements of IRC 117 and the regulations thereunder; and
 - H. **Percentage Test:** if the employer-related scholarship program provides grants to employees' children, the scholarships awarded must not exceed: (i) 25% of the number of employees' children who were eligible, applied for scholarships, and were considered by the selection committee in selecting the recipients; or (ii) 10% of the number of employees' children who were eligible (whether or not they submitted an application) in that year. *See Rev. Proc. 85-51, 1985-2 C.B. 717 for requirements in determining the number of employees' children who can be eligible recipients for purposes of the 10% test. If the employer-related scholarship program provides grants to employees, the scholarships awarded must not exceed 10% of the number of employees who were eligible, were applicants for such grants, and were considered by the selection committee in selecting the recipients of grants in that year.*
 - I. If the employer-related scholarship program satisfies the seven conditions but not the percentage test, the program may nevertheless qualify if, in view of all the facts and circumstances, its primary purpose is to educate recipients in their individual capacities. See section 4 of Rev. Proc. 76-47 for facts and circumstances test requirements. See Rev. Rul. 86-90, 1986-2 C.B. 184 for application of the facts and circumstances test to a program involving one scholarship awarded to a child in an employee pool of thousands.
2. Only employer-related grant programs must satisfy Rev. Proc. 76-47. An employer-related grant program is defined as a program that:
 - A. treats some or all of the employees (or their children) of a particular employer as a group from which recipients of some or all of the private foundation's grants will be selected;
 - B. limits the potential recipients to individuals who are employees (or their children) of a particular employer; or
 - C. otherwise gives such individuals a preference or priority over others in being selected as recipients of such grants.
3. For specific examples, see the following revenue rulings.
 - A. Rev. Rul. 79-131, 1979-1 C.B. 368, holds that an employer funded scholarship program for all students in a community is not an employer-related grant program as defined in Rev. Proc. 76-47.

- B. Rev. Rul. 79-365, 1979-2 C.B. 389, holds that a private foundation's scholarship program is within the scope of Rev. Proc. 76-47.
 - C. Rev. Proc. 94-78, 1994-2 C.B. 833, permits rounding off of the number of employer-related scholarship or loan grants.
 - D. See also, Rev. Rul. 81-217, 1981-2 C.B. 217, which discusses the application of Rev. Proc. 76-47 to two particular situations.
4. Long-term or short-term educational loans made under an employer-related educational loan program may qualify as grants described in IRC 4945(g)(3), provided they meet the requirements in Rev. Proc. 80-39, 1980-2 C.B. 772. The requirements of Rev. Proc. 80-39 are essentially the same as those in Rev. Proc. 76-47 (concerning educational grants). For details, see Rev. Proc. 80-39.

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