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This article presents general guidelines for Georgia nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.

Staying Tax-Exempt: Avoiding Pass-Through Payments to Individuals

As a general rule, a donation to a §501(c)(3) nonprofit charitable organization may be tax-deductible, while a gift to an individual is not tax-deductible. Donors and §501(c)(3) nonprofit organizations cannot take advantage of this rule by passing payments from donors, through the §501(c)(3) nonprofit organization to specific individuals. An organization which participates in this type of transfer — called a pass-through payment — on a regular and ongoing basis is at risk of losing its §501(c)(3) tax-exempt status.

A pass-through payment is a "donation" which is given to a §501(c)(3) organization, but with the understanding or intention that it is actually passed through that organization to benefit a specific individual. The key in distinguishing pass-through payments from true donations is the amount of control and discretion that the organization has over how the money will be spent.

In the case of a pass-through payment, the organization has little control over how the money is spent. The donor has given the money with the understanding that it will be given to a specific person, and the organization has simply passed that money on to that person. The donor claims a tax deduction, but the money benefits the individual rather than furthering the organization's mission.

In contrast, a true donation requires the organization's control and discretion over how to spend the donated funds. Although a donation may be restricted and given to fund a specific project or to support the salary of a specific position within the §501(c)(3) nonprofit organization, these are mission-related activities of the organization and controlled by the organization.

If money is donated to fund a specific position's salary, that money does not belong to the person who holds the position. For example, Charity A, a §501(c)(3) organization, creates a new Communications Director position with a set salary and hires Suzanna Jones for the job. Suzanna's grandma wants to support Suzanna so she donates to Charity A to help fund the new Communications Director position. If Suzanna leaves Charity A, she does not receive the money that her grandma donated to Charity A to take with her. That donation continues to fund the Communications Director position no matter who is in the role. In addition, the salary doesn't necessarily change just because more donations are received than are needed. The restricted fund can now fund multiple years of the Communication Director salary.

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Another example involves missionaries. Many missionaries raise the funds to support their work on their mission trips. For example, Missionary Z solicits donations when speaking at various churches with the donations going to Charity B. Charity B's mission includes the mission work that Missionary Z does. The money that is raised by Missionary Z for Charity B is not controlled by Missionary Z. The donations can go into a fund for mission trips and missionary activities, but it does not pass-through to Missionary Z. Charity B must separately set the salary and permissible expense amount for the missionaries going on its mission trips and conducting its mission activities. Missionary Z should only receive the set salary and permissible expense reimbursement. Further, if Missionary Z leaves the organization or resigns from the position Missionary Z is not entitled to the money that he or she raised — instead, it stays with Charity B to be used for the person who replaces that missionary or other missionary work.

An organization should also make sure that it solicits donations in a way that does not imply that it will be used for a specific individual. The IRS recommends that donation receipts or solicitations contain appropriate language such as: "This contribution is made with the understanding that the donee organization has complete control and administration over the use of donated funds."

Other best practices to maintain appropriate control over funds include:

- Donation checks should be made out to the organization, not the individual.
- Donations should go into a common pool to be distributed according to the organization's efforts and needs, not according to the amount that an individual personally raised.
- Donors should intend to support the organization's goals or missions, rather than to give a gift to an individual.
- If the donations are used to fund a salary, a specific salary amount should be set and the salary funds should stay with the position, rather than the individual.
- No commitment or understanding should be made that contributions will be used for a designated beneficiary.