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 may not skirt this rule by passing payments from donors, through the §501(c)(3) nonprofit organization, to specific individuals. An organization that 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 money that is given to a §501(c)(3) organization, but with the understanding or intention that it will directly benefit a specific individual. The key in distinguishing pass-through payments from tax-deductible 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 gives the money with the understanding that the organization will give it to a specific person, and the organization simply passes the money on to that person. The money benefits the individual rather than furthering the organization’s mission. Pass-through payments are not tax-deductible to the donor.

In contrast, a tax-deductible donation requires the §501(c)(3) nonprofit organization to have control and discretion over how to spend the donated funds. Although a donation may be restricted and given to fund a specific project or even to support the salary of a specific position within the organization, the donation supports mission-related activities of the organization and the organization controls the funds.

Money may be donated to fund a specific position’s salary, but 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 learns about Suzanna’s new job and is excited about Charity A’s mission. She donates to Charity A to help fund the new Communications Director position. If Suzanna leaves Charity A, she may not take the money that her grandma donated to Charity A with her. That donation must continue to fund the Communications Director position no matter who is in the role. In addition, the salary should not change just because Charity A receives more donations than are needed to cover the salary. In that case, the excess funds can be used to fund multiple years of the Communications Director salary.

Another example involves missionaries. Many missionaries raise the funds to support their work on their mission trips. For example, Caleb Johnson does mission work for Charity B, a §501(c)(3) nonprofit organization that organizes mission trips to other countries. Caleb solicits donations when speaking at various churches with the donations going to Charity B. Caleb should not control the money that he raises for Charity B. The donations can go into a fund for mission trips and missionary activities, but it may not pass through to Caleb. Charity B must separately set the salary and permissible expense amount for the missionaries going on its mission trips and conducting its mission activities. Caleb should only receive the set salary and permissible expense reimbursement. Further, if Caleb leaves the organization or resigns from the position, he is not entitled to the money that he raised. Instead, it stays with Charity B to be used for the person who replaces Caleb or for other missionary work.

An organization should make sure that it solicits donations in a way that does not imply that they 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.