

Providing
Scholarships and
Other
Financial Assistance



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Mission of Pro Bono Partnership of Atlanta

To provide free legal assistance to community-based nonprofits that serve low-income or disadvantaged individuals.

We match eligible organizations with volunteer lawyers from the leading corporations and law firms in Atlanta who can assist nonprofits with their business law matters.

Client Criteria

In order to be a client of Pro Bono Partnership of Atlanta, an organization must:

- Be a 501(c)(3) nonprofit.
- Be located in or serve the greater Atlanta area.
- Serve low-income or disadvantaged individuals.
- Be unable to afford legal services.

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PBPA Learning Center for Georgia Nonprofits

www.pbpatla.org/resources

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Legal Information

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

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Agenda

- Structural & Legal Overview
- Scholarships or Financial Assistance?
- Best Practices for Program Creation & Administration

Scholarships vs. Financial Assistance

- What is the basic difference? Whether the award will be taxable.
- Scholarships are nontaxable to the recipient if
 - Your organization follows the criteria we will discuss in this presentation and
 - Makes the appropriate filings with the IRS.

Laws Applicable to Scholarships

- §4945(g)(1) of Internal Revenue Code
- §4966 of Internal Revenue Code
- §117 of Internal Revenue Code
- §170 of Internal Revenue Code

Requirements for Scholarships

The group of applicants from which recipients are selected must be sufficiently broad to be considered a charitable class

- Sufficiently large and indefinite
- Cannot benefit a small group of pre-selected or pre-named individuals
- Examples of charitable classes:
 - Students at colleges and universities in Atlanta
 - High school students from low-income families in Georgia
 - Female college students in the US
 - High school seniors graduating in the top 10% of their class

Requirements for Scholarships

Must be awarded on an objective and nondiscriminatory basis. Examples include:

- Financial need
- Academic performance/merit
- Performance on standardized tests (e.g., SAT/ACT)
- Community involvement and/or extracurricular activities
- Recommendations from teachers or others in the community

Requirements for Scholarships

May not be awarded to insiders:

- officer, manager or trustee of your organization
- member of the selection committee
- a substantial contributor
- certain US government officials
- family members of any of these individuals

Requirements for Scholarships

To be excluded from gross income, it must be a “qualified scholarship” received by an individual who is a candidate for a degree at and used for study at an educational institution described on Section 170(b)(1)(A)(ii) of the Internal Revenue Code

- “Qualified Scholarship”: used for qualified tuition and related expenses at such an institution
 - Tuition and required fees, books, supplies and equipment

Rules for Public Charities

- No member of the selection committee can benefit in any way from choosing the scholarship recipients (e.g., committee members cannot have relatives in the applicant pool).
- You can donate money to a 501(c)(3) school and recommend that they grant scholarships to certain applicants, but the school must have the final say on which students actually receive scholarships.
- You must ensure that any non-U.S. citizen who receives a scholarship is not a published “Specifically Designated Nationals” terrorism watch list (search engine) found here: <https://sanctionssearch.ofac.treas.gov/>

Rules for Private Foundations

All the above rules for public charities apply to private foundations, plus the following:

- **If you give scholarships to selected students:**
You must obtain pre-approval of your selection procedure from the IRS by submitting a request for pre-approval at least 45 days before you make your first award.
- **If you fund scholarship programs at educational institutions:**
If the grant is conditioned on certain students receiving scholarship funds, the rules that apply to the scholarship awards to selected students described above apply.
- **If your foundation is affiliated with a business entity:**
If employees of the business or their children are eligible for scholarships, your program must strictly follow a number of additional rules for the funds to be nontaxable.

Difference: Preapproval

- Under IRC Section 4945, **private foundations**, which are one subcategory of Section 501(c)(3) organizations, must obtain pre-approval from the IRS for their procedures for selecting recipients of scholarship grants in order to pay scholarship grants
- **Public charities** are not obligated to obtain IRS pre-approval, but public charities generally look to the federal tax rules for private foundation scholarship grants when structuring scholarship grant programs

Conditions Required for Employee-Related Scholarships

To be Nontaxable

- Use as inducements prohibited
- Independent Selection Committee
- Minimum Eligibility Requirements
- Objective Basis for Selection
- Eligibility not contingent upon continued employment
- Course of Study
- Other objectives

If these conditions are not met, the IRS may consider the grant a taxable expenditure and the foundation could lose its exempt status.

Rules for Donor Advised Funds

Donor Advised Funds: A separately identified fund or account that is maintained, operated, and legally controlled by a 501(c)(3) organization, called the sponsoring organization.

- Donor has advisory privileges over the distribution of funds from the DAF, but the sponsoring organization must have legal control over the funds in the DAF and the right to disregard the donor's advice
- Donor can claim a charitable deduction for income-tax, gift-tax or estate-tax purposes only if the donor obtains a written acknowledgment from sponsoring organization stating that it has exclusive legal control over the assets contributed to the DAF
- BUT, IRC Section 4966 prohibits DAFs from granting scholarships to individuals unless they fall within specific exceptions

Rules for Donor Advised Funds

IRC Section 4966 outlines types of funds that are excluded from the definition of a DAF.

- The definition of a donor advised fund in the Code does not include any fund which makes grants to individuals for travel, study or other similar purposes if
 - (i) the fund is advised by a committee all the members of which are appointed by the sponsoring organization,
 - (ii) the committee is not controlled by the donor or donor advisor to the fund (or any persons related to the donor or donor advisor), and
 - (iii) all grants from the fund are awarded on an objective and non-discriminatory basis pursuant to a procedure approved in advance by the governing board of the sponsoring organization, provided that the procedure meets the requirements for private foundation grants to individuals for travel, study or other similar purposes.

Therefore, if a fund falls within this exception, scholarship grants to individuals may be paid out of the fund without violating the general prohibition in the Code on donor advised fund distributions to individuals.

IRS Filings

In addition to meeting the applicable requirements above, your organization must provide information about scholarships on Schedule H of Form 1023, and on Form 990.

Form 1023 Schedule H – must provide:

- Criteria used for selecting recipients, including the rules of eligibility.
- How and by whom the recipients are or will be selected.
- If awards are or will be made directly to individuals, whether information is required assuring that the student remains in school.

IRS Filings (cont)

- If awards are or will be made to recipients of a particular class, for example, children of employees of a particular employer:
 - Whether any preference is or will be accorded an applicant by reason of the parent's position, length of employment, or salary.
 - Whether the recipient must accept employment with the company upon graduation as a condition of the award.
 - Whether the award will be continued even if the parent's employment ends.
- A copy of the scholarship application form and any brochures or literature describing the scholarship program.

IRS Filings (cont)

- Form 990
 - Domestic Individuals: An individual who lives or resides in the United States, at the time a scholarship grant is paid or distributed to the individual
 - Part III of Schedule I of IRS Form 990
 - Total number and total amount of scholarship grants paid during the applicable tax year
 - Foreign Individuals: An individual, including a U.S. citizen or resident, who lives or resides outside of the United States, at the time a scholarship grant is paid or distributed to the individual
 - Part III of Schedule F of IRS Form 990
 - Total number and total amount of scholarship grants paid during the applicable tax year by geographic region

Should You Award Scholarships or Financial Assistance?

- As mentioned, scholarships are nontaxable to the recipient only if your organization follows the above-mentioned criteria and makes the appropriate IRS filings.
- If your organization is unable to meet the applicable criteria or would prefer not to have to comply with them, then provide financial assistance.

Should You Award Scholarships or Financial Assistance? (cont)

- Available funds for awards and the financial and personnel resources available to create and administer the program are some factors to consider in making this decision.
- If you are already providing awards and are not complying with applicable scholarship laws and regulations, consider calling your awards financial assistance rather than scholarships.

Best Practices for Creation and Administration a Scholarship or Financial Assistance Program

Evaluate Governing Documents

Check the Purpose clause of the document(s): Is offering scholarships permissible within the mission of the organization?

The mission doesn't have to state that it provides scholarships but make sure that providing such scholarships would not be contradictory to the mission.

Applications

- Creating Forms
- Standardize Deadlines
- Don't Charge Fees
- Don't ask for Social Security Numbers
- Proofread!

Selection Criteria

- Be as Specific as Possible
- Identify Objectives
- Relate Objectives to Concrete Criteria
- Limit Essays and Other Subjective Criteria
- Create a Review and Scoring Process

Communications with Applicants and Recipients

- Post scholarship information on websites and/or databases
- Create online application forms and materials
- Send email or text acknowledgements and notifications

Award

Provide an award agreement to be signed by both parties. List any terms and conditions, including:

- Set forth amount/term of grant, and conditions for renewal (if renewable)
- How grant will be paid
- Any conditions which would require repayment
- Reporting obligations and tax obligations of recipient, if any

Payment of Funds

- For scholarships, it is usually best to pay to the educational institution directly. If funds are paid to recipient directly, they must verify that money is spent on tuition fees, or supplies to keep funds non-taxable, which requires additional recordkeeping
- Financial assistance can be paid directly to the recipient

Evaluating the Effectiveness of Your Program

Track and Evaluate Measurable Outcomes

- Retention and Graduation Rates
- Other Awards Won by Your Recipients
- Average Recipient Debt at Graduation
- Enrollment in Graduate and Professional Schools

Documentation / Recordkeeping

- Establish or review standard recordkeeping processes. Maintain records for a minimum of three years.
- Maintain records on overall award process and procedure, including:
 - The types, purposes and amounts of grants to be awarded
 - How the scholarship grants are publicized
 - Eligibility and selection criteria for the scholarship grants
 - Composition of the selection committee
 - Specific documentation about each year's process
 - Copies of all applications
 - Signed copies of award agreements
 - Procedures used to supervise the use of the scholarship grants

Managing Your Program

- Internally: Assign Specific Personnel and Establish Internal Procedures for Management
 - National Scholarship Providers Association
- Outsourcing: Scholarship Management Organizations
 - Eliminate burdens and limit costs
 - Avoid possibility of actual or perceived conflicts
 - Get assistance with outreach

Questions?

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