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## **Funding Prizes, Contests, and Geniuses**

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*The growing use of charitable prizes and competitions as another tool in a philanthropist's toolbox to achieve impact offers opportunities and challenges from a policy and legal standpoint. Learn about these opportunities and challenges and the rules of the road for charitable organizations interested in giving prizes and awards, including the taxable expenditure rules, income tax considerations, and state regulatory regimes.*

### **1. What is a prize or award?**

- a. For federal income tax purposes, the definition of prizes and awards is consistent with the plain English meaning: Something given as a reward to the winner of a competition or in recognition of an outstanding achievement.
  - i. The Code and Treasury Regulations do not define “prize” or “award,” but the Treasury Regulations illustrate prizes and awards as “amounts received from radio and television giveaway shows, door prizes, and awards in contests of all types, as well as any prizes and awards from an employer to an employee in recognition of some achievement in connection with his employment.”<sup>1</sup>
  - ii. The Code also contemplates the exclusion from gross income (under certain conditions) of prizes “in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement.”<sup>2</sup>
  - iii. The Code and Treasury Regulations thus indicate that the distinguishing features of prizes and awards are that they are given in connection with competitions, contests, or achievements.
- b. Different legal and tax considerations will apply to a prize or award depending on (i) how it is awarded and (ii) how it is required to be used.

### **2. How do prizes and awards further charitable purposes?**

- a. Existence of the prize or award may itself further charitable and exempt purposes:
  - i. Incentivizing charitable and educational pursuits by recognizing past achievement.

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<sup>1</sup> Treas. Reg. § 1.74-1(a).

<sup>2</sup> Code § 74(b).

- ii. Encouraging innovation/excellence by rewarding ideas or solutions.
- b. The recipients may constitute a charitable class:
  - i. Innovation/effectiveness grants to charitable organizations.
  - ii. Scholarship awards to low-income students.
- c. The winner may be required to use the prize in a way that furthers charitable or exempt purposes:
  - i. Invest funds in a charitable project.
  - ii. Use funds for education or to complete a research project.
- d. In all cases, the prize or award must be administered and/or used primarily for these charitable purposes, and any private benefit must be incidental or tenuous.
  - i. Award should not be designed to incentivize conduct that furthers the business or personal interests of the donor (e.g., a prize for technological breakthroughs that would enhance the products of the funder corporation).
  - ii. If awards are given to individuals or for-profit entities, then either (i) they should be required to be used for charitable purposes by the recipient or (ii) the personal benefit to the recipient should be minor relative to the public impact of the award program.
  - iii. Additional rules may apply if the funder is a private foundation or donor advised fund.
  - iv. In general, funders and organizational insiders or employees should not be eligible for awards.

### **3. Why do philanthropists use them?**

- a. Seek outside ideas, but continued control over process.
- b. Encourage innovation and find solutions to problems.
- c. Highlight an issue and create excitement.
- d. Ability to recognize special talent, find hidden gems and be selective.
- e. Opening the lens wide to capture a larger field of applicants/contestants.
- f. Pay only for results.

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