

NONPROFIT ORGANIZATIONS INSTITUTE

MASTER CLASS

# The Complexity of Giving:

Expenditure Responsibility and the Individual Grant Rules



**Jennifer Shipp**

Heising-Simons Foundation  
Los Altos, CA



**Caroline Waldner**

Morgan, Lewis & Bockius LLP  
Washington, DC



1

## Overview of ER Requirements

- Section 4945 of the Internal Revenue Code imposes initial and additional taxes on “taxable expenditures” of a private foundation.
- “Taxable expenditures” include grants to organizations other than 509(a)(1) and 509(a)(2) public charities, certain 509(a)(3) supporting organizations, and exempt operating foundations unless the private foundation exercises expenditure responsibility/ER.
- Expenditure responsibility must be exercised for grants to:
  - Non-charitable organizations
  - Private foundations
  - Non-functionally integrated Type III supporting organizations and other supporting organizations where a disqualified person of the foundation controls the supporting organization or its supported organization(s)
  - Earmarked grantees that are one of the above

2

2

1

## Penalties for Failing to Comply with ER Requirements

### ■ First Tier Taxes:

- A 20% tax on the private foundation
- A 5% tax on management for knowing that it is a taxable expenditure
  - Requires management to be willful and for there to be reasonable cause

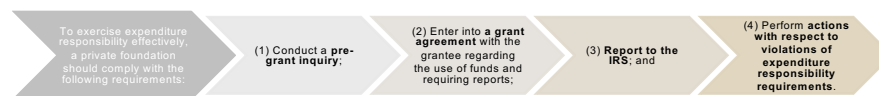
### ■ Second Tier Taxes:

- An additional 100% tax on the private foundation for failing to correct a taxable expenditure within the taxable period
- An additional 50% tax on management for failing to correct the taxable expenditure within the taxable period

3

3

## Overview of Expenditure Responsibility Requirements



4

4

## Pre-Grant Inquiry

- Private foundations should conduct a limited inquiry concerning the potential grantee before the grant is made.
- Inquiry should look at:
  - Identity;
  - Past history and experience;
  - Management;
  - Activities; and
  - Practices of the grantee organization.
- Such inquiry should be complete enough to give a reasonable person assurance that the grantee will use the grant for the proper purposes, and the foundation should maintain documentation of this process.

5

5

## Helpful Documents for a Pre-Grant Inquiry

- Potential grantee's formation documents
- Annual reports
- Audited financial statements
- Business plans
- Organizational charts
- A list of directors and officers
- Other documents or information related to the management, activities, and practices of the grantee in relation to the grant's purpose

6

6

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](https://utcle.org/elibrary)

## Title search: MASTER CLASS: The Complexity of Giving: Expenditure Responsibility and the Individual Grant Rules

Also available as part of the eCourse

[2024 Nonprofit Organizations eConference](#)

First appeared as part of the conference materials for the  
41<sup>st</sup> Annual Nonprofit Organizations Institute session

"MASTER CLASS: The Complexity of Giving: Expenditure Responsibility and the Individual Grant Rules"