



City of Rolling Hills

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Mtg. Date: 05/13/2024

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

FROM: CHRISTIAN HORVATH, CITY CLERK / EXECUTIVE ASSISTANT TO CITY MANAGER

THRU: KARINA BAÑALES, CITY MANAGER

SUBJECT: CONSIDERATION AND POSSIBLE ACTION TO PROCEED WITH IRS CODE SECTION 170(C)(1) FOR CHARITABLE CONTRIBUTIONS USED FOR PUBLIC PURPOSES

DATE: May 13, 2024

BACKGROUND:

On June 26, 2023, the Charitable Foundation Ad Hoc Committee (Mayor Leah Mirsch and Councilmember Patrick Wilson) presented the City Council with a status update on exploring the establishment of a charitable 501 (c) foundation for the City of Rolling Hills (Attachment A). During the meeting, the committee presented findings on how other Peninsula Cities have successfully established similar 501(c) foundations, detailing their achievements and organizational structures. This information provided valuable insights into potential models and strategies that could be adapted to suit Rolling Hills' unique needs and objectives.

While the committee initially considered the possibility of establishing a 501(c) organization, it subsequently identified an additional mechanism, Section 170(c)(1) of the Internal Revenue Code, which specifies the types of organizations and donations that can be made by donors and qualify for a tax deduction. These organizations include religious organizations, educational institutions, hospitals, medical research organizations, and governmental units (if the contribution is made exclusively for public purposes). The City of Rolling Hills is a governmental unit and, thus, comes under the purview of IRS Code Section 170(c)(1). Similar to a 501(c)(3) entity, IRS Code Section 170(c)(1) entities are eligible to receive tax-deductible charitable contributions under this provision with the added benefit of not having to create a separate legal entity.

On February 12, 2024, the Ad Hoc Committee and staff presented a report that the 170(c)(1) was worth pursuing and directed staff to return with a more refined 170(C)(1) action plan.

DISCUSSION:

Subsequent to the February 12, 2024, City Council discussion, City staff has researched the utilization of accepting charitable donations under section 170(c)(1) and answered some

questions below.

What is the difference between section 501 (c)(3) and section 170?

All of the 501(c) sections, including 501(c)(3), describe particular types of organizations that qualify for tax exemption. Section 170 provides that contributions to certain types of organizations—primarily 501(c)(3)s and a few others—are deductible by the donor as itemized deductions. Section 501(c)(3) governs the tax exemption of organizations, while section 170 governs the deductibility of contributions by individuals to various types of organizations, including governmental units.

How does one distinguish Nonprofits, Tax-Exempt Organizations, and Qualified Charities

Nonprofits, tax-exempt organizations, and qualified charities are all entities created to achieve social good. It is possible that an entity could be all three at once, but for the purposes of the Internal Revenue Code (IRC), these are distinct types of organizations.

- **Nonprofits** - As the name indicates, a nonprofit is created for purposes other than generating profit, so no part of the organization's income can be distributed to its members, directors, or officers. Nonprofit status is conferred under state statute rather than federal law, so the requirements of and benefits to these organizations vary from state to state. As an entity formed under state statute, a nonprofit must follow all state requirements and entity organizational filing requirements.
- **Tax-exempt organizations** - A tax-exempt organization is a nonprofit that is exempt from federal income taxation—a clear advantage indeed. To qualify for tax-exempt status, a nonprofit must be organized and operated exclusively for one or more exempt purposes, as identified in the Internal Revenue Code. The types of organizations that can claim tax-exempt status are listed in IRC Sec. 501(c).
- **Qualified charitable organizations** - For a donor to receive a charitable tax deduction for a contribution, the charity must not only be tax-exempt, it must also be "qualified." A charity may be qualified for income tax purposes but not necessarily qualified for gift and/or estate tax purposes—IRC Secs. 170(c), 2522, and 2055(a) individually list the categories of qualified charities that allow a donor to deduct contributions for income, gift, and estate tax (respectively).

What is an allowable Income Tax deduction for gifts to qualified entities?

Donors make charitable donations for any number of reasons—a personal connection to the charity, a desire to help a specific cause, a family tradition of support, or a tradition of charitable giving in general. Though it may not be the primary reason donors give, the income tax charitable deduction plays a role in philanthropic decisions and is the nexus between philanthropic intentions and tax planning.

Under IRC Sec. 170(c), a contribution or gift must be to or for the use of:

- The United States, a State, a possession of the United States, or any political subdivision, or the District of Columbia, but only if made for public purposes
- A corporation, trust, or community chest, fund, or foundation organized for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports, or for the prevention of cruelty to children or animals
- A post or organization of war veterans
- A domestic fraternal society, order, or association operating under the lodge system, but only if contributions are used exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals

- A cemetery company owned and operated exclusively for members and not for profit, with no part of the earnings benefitting any private shareholder or individual

What amount of a charitable contribution is deductible?

Not every charitable contribution will be deductible in the same way for income tax purposes. Generally, you can deduct up to 60% of your adjusted gross income from charitable donations. However, depending on the type of organization and type of contribution, you may be limited to 20%, 30%, or 50%. There are distinctions to draw between the deductibility of contributions made to a 50% organization as opposed to a 30% organization. Lastly, for individuals, charitable contributions are only available to those who itemize their deductions on IRS Form Schedule A versus taking the standard deduction.

What qualified charities expressly described under IRC Sec. 170(b)(1)(A) are considered 50% Limit Organizations?

- Churches
- Hospitals and medical research organizations
- Educational organizations
- Governmental unit
- Publicly supported charities
- Certain private foundations
- Supporting organizations

Non-50% Limit Organizations are those that do not meet any of the qualifications above. This includes gifts to veterans' organizations, fraternal societies, nonprofit cemeteries, and certain private non-operating foundations.

The City of Rolling Hills is described under section 170(b)(1)(A)(v) as a "governmental unit," and as such, is classified as a public charity and not a private foundation under section 509(a)(1).

Can the City accept contributions or gifts, and for what purpose?

Under Code Section 170(c)(1), IU, as a governmental entity, is an eligible recipient of charitable contributions for federal income, estate, and gift tax purposes. Likewise, those charitable contributions may be deducted by donors for federal income, estate, and gift tax purposes. Such contributions and gifts can be used by the City of Rolling Hills exclusively for public purposes.

What steps does the City need to take to receive affirmation of tax-exempt status?

Government entities are frequently asked to provide a tax-exempt number or "determination" letter to prove its status as a "tax-exempt" or charitable entity. For example, applications for grants from a private foundation or a charitable organization generally require this information as part of the application process. In addition, donors frequently ask for this information as substantiation that the donor's contribution is tax deductible, and vendors ask for this to substantiate that the organization is exempt from sales or excise taxes (exemption from sales taxes is made under state law rather than Federal law).

The Internal Revenue Service does not provide a tax-exempt number. A government entity may use its Federal TIN (taxpayer identification number), also referred to as an EIN (Employer Identification Number), for identification purposes.

Governmental units, such as states and their political subdivisions, are not generally subject to federal income tax. Political subdivisions of a state are entities with one or more of the sovereign powers of the state, such as the power to tax. Typically, they include counties or municipalities and their agencies or departments. Charitable contributions to governmental units are tax-deductible under section 170(c)(1) of the Internal Revenue Code if made for a public purpose.

As a special service to government entities, the IRS will issue a “governmental information letter” free of charge. This letter describes government entity exemption from Federal income tax and cites applicable Internal Revenue Code sections pertaining to deductible contributions and income exclusion. Most organizations and individuals will accept the governmental information letter as the substantiation they need.

Government entities can request a governmental information letter by calling 877-829-5500.

What does a local government need to provide a donor to substantiate the gift for IRS purposes?

See Attachment A, IRS Publication 1771, "Charitable Contributions – Substantiation and Disclosure Requirements."

Has the IRS issued final regulations on donations to charities in exchange for SALT (State and Local Taxes) credits?

The IRS issued final regulations (TD 9907) under IRC Sections 162, 164, and 170 regarding limitations on the deductibility of charitable contributions made in exchange for state or local tax credits.

For the most part, the final regulations adopted proposed regulations issued in December 2019 (REG-107431-19), with some clarifications in response to the comments and testimony the IRS received.

The final regulations:

1. adopt the safe harbor under IRC Section 162 for businesses that make payments to IRC Section 170(c) entities;
2. adopt the safe harbor under IRC Section 164 for individuals who make payments to IRC Section 170(c) entities if the individuals itemize deductions and receive, or expect to receive, a state or local tax credit in return; and
3. update the IRC Section 170 regulations to address how the quid pro quo principle applies to donors who receive benefits from a third-party in exchange for contributions.

For more details, see Attachment B.

Next Steps

Based on the research conducted, City staff concludes that there is no specific entity, be it a formal board or separate governance structure, that is required to be created or formed to utilize 26 USC 170(c)(1). This code section designates the authority for the position that gifts to the City may be tax deductible.

The City Attorney and staff would recommend that the City Council adopt a formal gift

acceptance policy that clearly defines the acceptance or denial of a gift or charitable contribution for public purposes (Attachment C).

FISCAL IMPACT:

Unknown at this time.

RECOMMENDATION:

Receive and file. Direct staff to return with a formal a policy for accepting gifts and donations for public purposes.

ATTACHMENTS:

[Attachment A - CL_AGN_240513_CC_IRS_CharitableContributions_p1771.pdf](#)

[Attachment B - CL_AGN_240513_CC_IRS_SALT.pdf](#)

[Attachment C - CL_AGN_240513_CC_GiftPolicy_D1.pdf](#)