

## NAVIGATING SCHOLARSHIPS AND GRANTS TO INDIVIDUALS

### A COMPARISON OF PHILANTHROPIC GIVING OPTIONS

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*This information is provided by Ask CMF, a technical assistance service of the Council of Michigan Foundations, for educational purposes only and does not constitute legal advice. Community foundations and other charitable organizations should not provide tax advice to donors or grantees and should instead encourage them to seek the advice of their own professional advisors.*

Community foundations, private foundations, companies and other grantmakers regularly reach out to CMF to learn how they can establish a scholarship program or other grantmaking programs that benefit individuals. Scholarships are one of the most common types of grants to individuals. This document is a reference tool for considering the variety of giving options available to philanthropy.

This resource is intended to provide an overview of important distinctions for establishing scholarships among the three primary institutions that house scholarship programs:

- **Community Foundations and Other Public Charitable Entities:** This category includes community foundations, university and community college foundations and other nonprofit organizations.
- **Private Foundations:** This category includes family foundations, corporate foundations and other grantmaking entities that are required to follow private foundation requirements set by the IRS.
- **Corporate Giving Programs:** This category includes internal philanthropy programs of corporations, banks, credit unions and other corporate entities. Corporations and related entities engaged in philanthropic activities should consult with legal counsel, as industry-specific rules and regulations may vary.

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## GENERAL CRITERIA OF SCHOLARSHIPS AND GRANTS TO INDIVIDUALS

The assets of 501(c)(3) organizations must be used to further charitable purposes (including education). If not, public charities threaten the loss of their charitable status and private foundations (and sponsoring organizations holding donor advised funds) may have these grants be considered taxable expenditures. Grants can be made to benefit individuals, as part of a scholarship program, disaster relief effort, or for other purposes to provide monetary awards.

**Governing Document Requirements:** While many foundations regularly engage in grantmaking intended for charitable organizations they may not necessarily have infrastructure in place to support grants to individuals. As an early step, foundations should check their governing documents (articles of incorporation and bylaws, or the trust agreement, as applicable) to ensure they are permitted to provide grants in the form of scholarships or other forms of support to individuals; some foundations are restricted to only provide relief to other 501(c)(3) organizations.

**Charitable Class:** Grants to individuals, including scholarship programs, require the designation of a sufficiently large (indefinite) “charitable class” so that it is not possible to know the identity of the recipient in advance. The charitable class is comprised of potential recipients who meet the requirements of the program’s criteria, while illustrating a benefit to the general community. Scholarships and similar programs cannot be established to benefit pre-selected individuals or a relatively small group of people, such as members of a family. Examples of charitable classes may include graduating seniors of a local high school or first-generation students of a local university. These charitable classes benefit from the fact that future classes are also eligible for these scholarships, making for an indefinite charitable class. (Additional information on selection criteria is included in the FAQ section.)

**IRS Regulations:** Private foundations are not entitled to make grants to individuals for travel, study or other similar purposes, unless such grants satisfy the requirements of [Internal Revenue Code \(IRC\) Section 4945\(g\)](#). The section encompasses scholarships or fellowships that qualify under IRC 117(a) and are to be used for study at an educational organization described in IRC 170(b)(1)(A)(ii), certain grants constituting a prize or award if the recipient is selected from the general public, or for grants whose purpose is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching or other similar capacity, skill or talent of the grantee.

The focus of this resource is scholarships and fellowships. Private foundations desiring to conduct their own scholarship programs (as opposed to donating money directly to a community foundation or educational institution for such grantee to choose scholarship awardees) must have their “objective and non-discriminatory” scholarship guidelines approved in advance by the IRS. Further, IRC 495 requires that any award to an individual for travel or study must meet the following requirements:

- Grant recipients must be chosen from a sufficiently large charitable class. (See above.)

- The selection criteria for recipients must be reasonably related to the purposes of the scholarship or grant program.
- Selection committee members must not derive direct or indirect private benefit from the selection of specific grant recipients.
- Grant selection must be made based on a procedure that will reasonably result in grantees carrying out the activities intended by the grant dollars.
- The grantor (foundation, nonprofit, etc.) must receive reports to determine that the intended activities funded by the grant are carried out. In the case of grants to schools and universities, the foundation may receive these reports directly from the organization. Grants made directly to individuals must require that the individuals themselves report back to the grantor regarding the use of their funds.
- Grants and scholarships may be renewed if the foundation has received all required reports on time, all criteria and procedures are objective and non-discriminatory, and the grantor has not received information indicating the misuse of the original funds. The foundation must pursue recovery of funds that have been mis-spent.

Please note that private foundations may still make grants to individuals for purposes other than travel or study (as outlined in IRC 4945), such as grants to low-income individuals to assist them with basic needs, so long as the private foundation keeps sufficient records so as to demonstrate to the IRS that the payments were for proper charitable purposes.

**Special Rules for Corporate Programs:** Corporate-sponsored scholarship programs, including scholarship funds established at community foundations by corporate foundations for the benefit of a particular employer's employees, have additional restrictions that stem from revenue procedures designed to ensure that these programs are not providing employer benefits such as additional compensation or employee retention and recruitment under the guise of charity. Accordingly, the main IRS guidance on this subject, IRS Rev. Proc. 76-47, requires that such scholarship program must meet the following factors:

1. The program is not used as a means of inducing employees to continue employment or follow a course of action.
2. The selection committee is independent of the employer.
3. The program identifies minimum requirements for grant eligibility.
4. Recipients are selected based on substantial objective standards unrelated to the employment of the recipients or their family members and to the employer's line of business.
5. The grant is not terminated because the recipient or his or her family member terminates employment.
6. The course of study for which grants are available are not limited to those that would be of a particular benefit to the employer.
7. The terms of the grant and the course of study for which grants are available must meet all other requirements of [Section 117](#) of the IRC and the regulations thereunder, and must be consistent with a disinterested purpose of enabling the recipients to obtain an education in their

individual capacities solely for their personal benefit and must not include any commitments, understandings or obligations, conditional or unconditional, suggesting that the studies are undertaken by the recipients for the benefit of the employer (or the related foundation) or have as their objective the accomplishment of any purpose (even though consistent with exempt status) other than enabling the recipients to obtain an education in their individual capacities and solely for their personal benefit.

In addition, the foundation must limit the number of scholarships awarded to (a) 25% or fewer of the eligible applicants who were actually considered by the selection committee in selecting recipients of grants in that year, or (b) 10% or fewer of the employees' children who can be shown to be eligible for grants (whether or not they submitted an application) in that year.

For more information regarding corporate philanthropy restrictions, see "[Choosing a Corporate Philanthropy Approach.](#)"

**Donor Advised Funds:** DAFs are prohibited from making grants to individuals. IRC 4966, which defines Donor Advised Funds, includes an exception to DAF with respect to an advised fund provides grants for travel, study, or other similar purposes, if—

- (I) Such person's advisory privileges are performed exclusively by such person in the person's capacity as a member of a committee all of the members of which are appointed by the sponsoring organization,
- (II) No combination of persons described in subparagraph (A)(iii) (or persons related to such persons) control, directly or indirectly, such committee, and
- (III) All grants from such fund or account are awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the board of directors of the sponsoring organization, and such procedure is designed to ensure that all such grants meet the requirements of paragraph (1), (2), or (3) of section 4945(g).

Typically if a DAF wants to fund scholarships, the community foundation will appoint members to a selection committee to vet potential recipients based upon criteria approved by the community foundation's board of directors. In such cases the donor and other DAF advisors and their family members, collectively, must compose less than a majority of such committee.

## A COMPARATIVE CHART OF PHILANTHROPIC GIVING OPTIONS FOR SCHOLARSHIPS AND GRANTS TO INDIVIDUALS

	Community Foundations and Other Public Charities	Private Foundations	Corporate Giving Programs
Legal Structure of Scholarship/Grantmaking Program	Community foundation, college/university, or other public charity houses the scholarship fund.	Distinct private foundation. The foundation is responsible for all legal and tax requirements of a private foundation.	Based within the corporation itself.
Administrative Costs and Set-Up	Community foundations and other public charities that hold scholarship funds may have an administrative fee for managing the scholarship within the institution. These organizations frequently create scholarships and should have the infrastructure in place to manage the legal and best practices required of a scholarship program.	Private foundations must obtain IRS approval of its scholarship procedures, as well as those intended for grants to individuals for travel or study under IRC 4945. This can be done when the foundation is established or at a later date but must be completed prior to any scholarships or grants to individuals being awarded. Does not apply if the private foundation makes a grant to a charity for purposes of scholarship if the foundation does not control the recipient selection.	Minimal administrative costs. Philanthropic efforts are established internally and can be coordinated in conjunction with tax/finance staff responsible for corporate deductions, or the corporate marketing team.
Scholarships	Community foundations and other public charities that manage scholarships use private foundation rules as the basis for best practice, although they do not need pre-approval by the IRS.	Can make scholarships, however the IRS must pre-approve the scholarship procedures or else the scholarships will be deemed taxable expenditures.	Not a deductible contribution by the company unless donated to a charity to conduct the program itself (outside of corporate control). If scholarships are open to employees and their families, additional rules must be followed.
Grants to Individuals (other than for travel or study)	Follows similar rules to scholarships. Some grants to individuals may be considered taxable to the recipient, depending on the purpose.	Allowable, with careful record keeping.	Not considered deductible unless generally supported through a public charity; individual recipients may not be known in advance.

	Community Foundations and Other Public Charities	Private Foundations	Corporate Giving Programs
Disaster Relief to Individuals	<p>May establish a disaster relief program for individuals or host an employee hardship fund on behalf of a corporation (or an employer-sponsored DAF, but only for federally qualified disasters).</p> <p>(See <a href="#">“Are there special rules for making grants to individuals involved in a disaster situation?”</a>)</p>	<p>May operate an employee disaster relief fund that provides employee disaster assistance for victims of federally qualified disasters only.</p> <p>(See <a href="#">“Are there special rules for making grants to individuals involved in a disaster situation?”</a>)</p>	<p>Can assist individual employees via an Employee Assistance Program maintained by an independent charitable entity. In a federally-declared disaster, the corporation can provide disaster relief support directly to employees.</p> <p>(See <a href="#">“Are there special rules for making grants to individuals involved in a disaster situation?”</a>)</p>
Composition of Selection Committee	<p>Selection committee members may be made up of community members, some of whom (less than a majority) may include the donor and/or family members.</p> <p>If a DAF, follow exception to DAF definition in IRC 4966 (noted above).</p> <p>Rules for donor involvement vary by institution. The donor or family members (employees of a corporation) may be involved in the selection of recipients. However, these individuals may not comprise a majority of these committees.</p>	<p>Selection committee members may be made up of foundation board members or other community members with special knowledge related to the scholarship or grant program.</p> <p>The primary donor or representatives of the funders may be included in the grantmaking process. However, donors and other parties may be considered disqualified persons and should avoid self-dealing situations. (Note: Self-dealing prohibitions apply regardless of who is involved in selection.)</p>	<p>Selection committees involving an employer/company must be comprised of individuals who are independent of the company.</p> <p>For employee hardship funds, selection of grantees cannot be made by a committee with a majority of members being corporate leaders, who could provide substantial influence over the company/employer, such as might be the case for a corporate foundation board making standard grants to charitable organizations. Employees who are not in leadership roles may participate on these committees.</p>

## FREQUENTLY ASKED QUESTIONS ABOUT SCHOLARSHIPS AND GRANTS TO INDIVIDUALS

### *Can I establish a scholarship via my Donor Advised Fund? Are there alternative options to direct scholarships?*

Donor advised funds cannot be used for grantmaking to individuals (including scholarships). However, DAFs can be used to support scholarships and similar initiatives in a number of ways, including:

- Recommending a grant to support general scholarships via a specific educational institution.
- Providing a grant to a specific educational institution to establish a scholarship program with restrictions. The educational institution then manages the scholarship program, including the selection of recipients.
- Funding a grant at an established community foundation or public charity that operates a scholarship program, choosing a charitable organization that serves a specific population of students.
- Establishing a scholarship fund at a community foundation or public charity, with some criteria for the selection of recipients. However, the charitable organization manages the scholarship fund, including the selection of recipients, although there may be limited donor involvement.

Depending on the organization managing the scholarship, DAF donors may be allowed to sit on the selection committee. However, these donors, DAF advisors and their respective family members are not allowed to constitute a majority of those deciding on the scholarship recipients.

### *Can scholarship funds be sent directly to a specific student or to their school?*

Foundations may prefer to send scholarship funds directly to the educational institution attended by the grant recipient. The school then becomes responsible for monitoring the use of the funds, ensuring they are used for the charitable/educational purpose for which they are intended. Otherwise, foundations providing grants directly to students must require reporting from the students about how they used the funds, in keeping with the original criteria of the scholarship program.

If the scholarship funds are paid to the school to offset the costs of tuition (and living expenses, if applicable), oversight is much easier as there is certainty that the funds are being used for charitable purposes. However, if the funds are paid directly to the student there must be oversight to ensure they are used for charitable purposes. Since funds are fungible, then proof of tuition bill, expenses, etc. would be sufficient to show that those costs add up to the scholarship amount or greater. If the student is no longer enrolled, the school (or student) would return the funds.

When private foundations make grants to individuals there is always the requirement to (i) ensure funds were spent for charitable purposes; (ii) take reasonable steps to recover any unused funds; and (iii) not make any more grants to the person who diverted funds until they have fully restored any diverted funds and have provided assurances (“extraordinary precautions”) that a diversion will not occur again.



### *What records should be maintained by the foundation for scholarships and other individual grants?*

Foundations should maintain records of all grants, including those directed to individuals through scholarship programs and similar initiatives. These records should be kept for at least three years beyond the annual IRS Form 990 or 990-PF filing covered by the last grant payment. Records for each grant should include:

- Information related to the individual grant program, including records related to complying with the required grantmaking procedures.
- All records and information used to evaluate grant applicants, both potential recipients and successful grant recipients.
- Information related to the purpose and amount of each grant or scholarship.
- Identification information for grant recipients.
- Information related to grant applicants with relationships to selection committee members (and their family members) and disqualified persons to the foundation.

### *Can I establish a scholarship for students attending trade schools or for-profit educational institutions?*

Scholarships can be established to benefit students attending educational institutions, including traditional preschool, K-12 schools and colleges/universities. In addition, scholarships may be granted to students attending trade schools and for-profit educational institutions, if the institution meets the following criteria:

- A regularly-scheduled curriculum.
- A regular faculty.
- An enrolled body of students attending the institution.

A foundation paying out a scholarship to a student attending a for-profit institution that fits this criteria would be considered a charitable activity. However, it would likely be prohibited private benefit to establish a scholarship fund specifically benefitting a particular for-profit educational institution.<sup>1</sup>

### *Can scholarships be used for room and board? Are these scholarships taxable for students?*

Scholarships for tuition, fees, books and supplies specifically required by a course (not general school supplies) are considered not taxable. However, costs such as room and board are considered taxable income to the recipient. While some scholarship programs managed by community foundations and similar institutions may permit their funds being used to cover these types of costs, payments for room and board, while permissible, are taxable income to the student. The IRS does not require withholding

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<sup>1</sup> Charitable organizations and charitable activity cannot be organized to benefit private interests, including people with a personal or private interest in the activities. For example, in the case of a scholarship designed for a broad class of students attending a specific for-profit institution, such a scholarship could be created by owners or beneficiaries of the for-profit, providing personal benefit to the business owners, regardless of the intended “charitable” purpose of serving students attending the institution, and this would therefore likely be prohibited.

when these funds are paid to U.S. citizens or “resident aliens,” only certain foreign students active within the U.S.

### ***Should the foundation provide a 1099 to a scholarship awardee or individual grant recipient?***

Although 1099s are typically required to be issued to a non-employee (individual or entity) to which payment of \$600 or more is made, there are exceptions for certain types of scholarships. Specifically, 1099-MISC is not intended to be used to report scholarship or fellowship grants. Scholarship programs that require teaching or similar services are considered taxable wages that must be reported on a Form W-2. Generally, other taxable scholarship or fellowship payments do not have to be reported to the IRS. Questions about the completion of tax forms for grant recipients as it applies to specific scholarship programs should be directed to qualified tax counsel.

### ***Can family members of selection committee members or donors receive scholarships?***

In most cases, community foundations and other organizations that manage scholarships have pre-established rules that define who is eligible for a scholarship or other grant program. Generally, best practice in the field dictates that these grants cannot be made to a board member, staff person, member of a selection committee or a donor, or their family members. Exceptions may be made, for example, if the high school principal always sits on the selection committee and the principal’s child is a potential grant recipient.

Some organizations go so far as to define who constitutes a “family member” or only provides this limitation to “substantial contributors” or those who created the specific scholarship fund. In addition, many procedural documents indicate that scholarships cannot be given to family members of these individuals, including those on the selection committee itself. In some cases, internal procedures may allow for selection committee members to recuse themselves for decisions that may impact family members’ eligibility to be considered for a scholarship program. Scholarships provided by private foundations and DAFs may not benefit any disqualified persons to the private foundation (as defined in IRC 4946; substantial contributors, officers, directors and their family members).

### ***Can veterans organizations, business leagues or social clubs establish scholarships at a community foundation?***

Community foundations are frequently approached by non-501(c)(3) organizations to establish scholarship funds that benefit their members and family members. As such a scholarship fund would provide direct benefit to members of these groups and this would not be considered a charitable activity. However, if such an organization approached the foundation to establish a scholarship for students attending a local educational institution and/or program that is not restricted to members and their family members, that option may be considered if the potential charitable class is large enough.

### *Can the foundation establish a scholarship specifically for students who are people of color?*

Donors and foundations regularly ask about establishing scholarships intended for students who are people of color. Scholarship applications can ask applicants to self-identify their race. Best practice in the field for selection criteria includes consideration of a number of characteristics of recipients, which may include race but also financial need and/or being a first-generation student at a higher education institution, or something similar. Organizations considering establishing this category of scholarship or grant program should consult with qualified legal counsel. Further information is also available via CollegeBoard's resource, "[Key Non-discrimination Principles and Actionable Strategies for Institutions of Higher Education and Private Scholarship Providers](#)." It is important to note that in Michigan and certain other states, state funds (even if granted to a community foundation) may not be used for affirmative action purposes, including gender- and race-based scholarships that would otherwise be permitted by a private institution.

### *Can the foundation increase the size of its scholarship fund pool?*

Typically, it is fine for the donor to add to the principal for future years or for the current year, so long as the selections have not yet been made. Once the selections are made, the grants are arguably earmarked for particular individuals and should not be increased.

### *Are there special rules for making grants to individuals involved in a disaster situation?*

Foundations can provide disaster relief grants to individuals in response to federally-declared or local disasters that do not receive a federal emergency declaration. Grantmaking efforts may serve as an extension of a foundation's standard grantmaking program or follow a special set of procedures that are only followed in the case of a federally qualified disaster. Often these grants are given to efforts within local communities. In some cases, foundations or giving programs may use discretionary funds to fast-track disaster grants. Rules against impermissible private benefit, self-dealing and recipient charitable class still apply for disaster situations and grants of this kind should not be intended to benefit disqualified persons.

The declaration of a national emergency under the [Robert T. Stafford Disaster Relief and Emergency Assistance Act](#) (such as occurred during the COVID-19 pandemic) triggers the provisions of Internal Revenue Code ("IRC") [Section 139](#). This section provides guidance to employers for providing "emergency relief payments" to staff without those payments being considered as taxable income to the employee and exempts such payments from being subject to unemployment insurance taxes to the employer.

Additional information about disaster grantmaking and forms of individual assistance is available in [IRS Publication 3833](#). This resource outlines how employer-related foundations, charities and donor advised funds can provide relief to individuals. This publication also outlines important restrictions for grantmakers interested in assisting local businesses and business owners who are impacted by disasters.

Disaster grants for individuals, as well as employee hardship funds, are not designed to, and may not, duplicate Federal Emergency Management Agency (FEMA) payments or insurance or other payments to individuals or families. As a result, emergency relief from community foundations and other charitable efforts are designed to help cover the remainder of basic needs created by the federally-declared emergency. An individual applying for this category of funding may receive assistance with medical expenses, funeral expenses, temporary housing, travel expenses for family members assisting a victim of a disaster, and other similar expenses resulting from the qualified disaster. Beyond the immediate aftermath of a disaster situation (when all individuals directly impacted may be in need of assistance), organizations must use objective criteria for evaluating victims' financial need to be considered charitable. These funds cannot be used to provide aid to pre-determined individuals or families (i.e. funds created to help a family facing a devastating fire), but these individuals can benefit from previously-established funds that assist families facing crises or funds can be created to benefit them and similar disaster situations with an open-ended charitable class.

The IRS Publication 3833 provides further clarity for employee hardship funds and similar efforts that are designed to benefit employees and their immediate family members. These funds can be used to provide assistance to the employee directly, in the case of the disaster impacting the employee's spouse or children, or to assist the family in the unfortunate case of the employee's injury or death.

To learn more about disaster grantmaking, visit CMF's "[Frequently Asked Questions About Disasters: A Resource for Grantmakers.](#)"

### *How can I learn more before giving a donation to support a scholarship or nonprofit?*

Donors interested in conducting due diligence on nonprofits and scholarship programs have a number of options.

- Talk with a nonprofit's staff or board members to learn more about the organization's activities and impact in the local community. For specific scholarship programs, contact the organization (school, university, etc.) that houses the program for more information regarding their existing procedures, administrative fees, criteria and other details.
- Look at a nonprofit's website to learn more about the organization's programs, structure and partners. Many nonprofits also include a full listing of staff, board members and annual reports.
- Donors and foundations interested in learning more about individual nonprofits can conduct further research by accessing organizations' IRS Form 990, a publicly available document that includes essential financial and management related information. These forms are available via searchable databases, such as [ProPublica's Nonprofit Explorer](#) and [GuideStar](#).
- For donors and foundations interested in checking the most up-to-date charitable status of a nonprofit organization, the IRS has a simple [Tax Exempt Organization Search](#) tool that is searchable by organizational name or Employer Identification Number (EIN).

## RECOMMENDED RESOURCES

- Central Valley Community Foundation. "Laws and Regulations Affecting Scholarship Programs." <https://www.centralvalleycf.org/wp-content/uploads/2018/01/Scholarship-Laws-05082017.pdf>.
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## ABOUT ASK CMF

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Documents Hub. Ask CMF is a free service to CMF members, available through the “Ask CMF” link on the CMF homepage or by visiting <https://www.michiganfoundations.org/practice/ask-cmf>.

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