

## Is It Possible To Be Too Generous?

*Ellen Lubell, Esq.*

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Absolutely. Giving to charity is great, of course, but too much generosity can spell trouble when you're the leader of a nonprofit organization.

### **Don't let benevolence get the better of your budget.**

Surprisingly often, nonprofit leaders place their desire to be generous so far ahead of financial return that they fail to develop a sustainable financial model. No matter how big-hearted they may feel distributing a product for \$10 that costs them \$20 to produce, at some point their generosity will catch up with them. Financial realities apply even if you're on the side of the angels.

### **Not all generosity is created equal.**

#### ***Private Inurement***

One problem with excessive generosity is known as "[private inurement](#)." The private inurement prohibition says that none of the income or assets of a tax-exempt nonprofit may be permitted to unduly benefit insiders (e.g. directors or trustees or their family members) or others who have a close relationship with the nonprofit or are in a position to exercise control over the nonprofit. For example, if a tax-exempt nonprofit hires an accounting firm that's owned by a member of the nonprofit's board, and pays the firm a fee that's higher than the norm for accounting services, this would be considered private inurement. The board member would gain a significant financial benefit as a result of his insider status. Generosity toward the board member may have been on the mind of the other board members who voted in favor of the firm, but it was seriously misplaced.

Sometimes arrangements that result in private inurement are entered into with the brazen goal of enriching certain individuals. More often, however, these arrangements are entered into with a genuine desire to be generous or do good, but without an understanding of the legal implications. The trustees of a school, for example, may want to provide financial help (without anything in return) to the school's founder who has fallen on hard times, but if they start a fundraising campaign on her behalf, they would be violating the tax law.

#### ***Private Benefit***

Another problem with excessive generosity is impermissible "[private benefit](#)." This prohibition is even broader than the private inurement prohibition and is not limited to income or assets: A tax-exempt organization may not provide private benefits to anyone that are more than just incidental—both qualitatively and quantitatively—to the organization advancing its mission. For example, a library hires a consultant for advice on redesigning the main reading room. The consultant's recommendations are innovative and on-budget. The library is so pleased that it pays the consultant a fee that is far above the going rate for this type of consulting. This is an impermissible private benefit. Hiring the consultant in the first place is fine, since a library should have a well-designed reading room, but paying the consultant an excessive fee does not advance the library's mission (and may actually impede its mission as resources are drained). The library may have simply intended to express its appreciation by paying the high fee, but that doesn't make it legal.

If, on the other hand, a nonprofit community center builds an outdoor playground for kids in a disadvantaged neighborhood, and kids from wealthy families in a nearby upscale neighborhood also use the playground, this is not an impermissible private benefit. The benefit to the wealthy kids is an incidental side-effect of the community center advancing its mission. It is incidental both qualitatively, because building the playground in a publicly accessible area was necessary to benefit the disadvantaged kids, and

quantitatively, because the wealthy kids are not receiving any special use or access beyond what is received by the disadvantaged kids.

### **The upshot?**

These violations of law may be inadvertent, but they can result in a loss of trust and sense of fair dealing that members of the public should otherwise feel toward nonprofits that supposedly serve them. If the violations are substantial and not corrected, they can result in penalties up to and including loss of tax exemption. As a nonprofit leader, you can't afford to remain uninformed on these issues. If that surge of generosity comes over you, consider getting [legal advice](#) before you act on it.

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With years of experience both as in-house and outside counsel, [Ellen Lubell](#) provides guidance to nonprofit leaders on policies and practices to avoid liability, preserve tax-exempt status, and assure the proper expenditure of resources.