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Victims' Funds May Violate U.S. Tax Law

No Sign I.R.S. Will Bend Rule for Sept. 11 Donors

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On Friday, Mayor Rudolph W. Giuliani announced that the city's Twin Towers Fund had written its first 73 checks to the families of the rescuers who died at the World Trade Center. The checks ranged from $50,000 to $325,000, and are part of $85 million in charity the mayor has promised to some 400 families.

But there is one problem: the payments may violate the federal tax laws governing charities.

With more than $1.3 billion donated to the victims of Sept. 11, the notion that this vast pool of charity could be more or less divided among all the affected families has gained currency with the public and some elected officials, who have promoted it as a solution to the logistical delays and red tape plaguing relief efforts.

Yet despite its appealing simplicity, this approach is clearly forbidden by Internal Revenue Service rules that govern tax-exempt charities, a senior I.R.S. official said in Congressional testimony last week.

The I.R.S. typically requires tax-exempt charities like the Twin Towers Fund to serve people who are in dire financial need: those who are struggling to afford mortgages, grocery bills and other basic necessities. Yet many of the families of the lost police officers and firefighters have already received tens of thousands of dollars in charity and all have considerable pension and death benefits. In certain cases, their family income is actually higher than it was before Sept. 11.

The Giuliani administration, which acknowledges that it announced the distribution plan without first getting formal approval from the fund's board of directors, said the payments were appropriate, arguing that the I.R.S. often gives charities greater leeway to distribute relief in the immediate aftermath of a disaster without first checking individual family finances. Administration officials said they did not have written approval from the I.R.S., but hoped that the agency would be flexible concerning uniformed personnel.

But it is clear that the problem of making prompt, generous payments to victims without violating charity law affects scores of organizations that have raised money primarily for specific World Trade Center victims, like the families of one corporation or one labor union.

It is especially troubling for funds that have raised huge sums for the families of lost uniformed personnel, and that now face a wrenching realization: tax-exempt charities are generally required by law to respond to specific needs, not to heroism.

A meeting of charity representatives last Friday at the Better Business Bureau in New York boiled down to people's commiserating, saying: " 'What are we going do? What are we going to do?' " recounted Pam Delaney, executive director of the New York City Police Foundation.

There could be significant consequences if they do the wrong thing. If the charities do not give aid to these families, in whose names they raised the money, they break faith with their donors. But if they simply make across-the-board payments to every family, regardless of financial need, they could lose their tax-exempt status and owe tens of millions of dollars in taxes, tax experts and charity officials say. They would also find it more difficult to raise new funds because they could no longer offer donors a tax deduction.

No one expects that any family will be forced to return money distributed thus far. But for those families, and hundreds of others, the demands of the tax code may mean even more paperwork if the Internal Revenue Service requires charities to verify through bank statements, bills and other financial documents that the families are in fact strictly qualified for aid.

"People say, 'Why should widows have to be beggars?' But that's the charitable law," said Victoria Bjorklund, a lawyer specializing in charity issues.

The I.R.S. does not comment on individual tax cases, but in testimony to Congress last Thursday, a senior I.R.S. official specifically warned charities against distributing money without first examining family circumstances to make certain that survivors are poor or distressed.

"An affected individual generally is not entitled to charitable funds without a showing of need," said Steven Miller, the director of the I.R.S. division that oversees charitable organizations.

Several lawyers who are advising charities said that based on their own conversations with Internal Revenue Service officials and a long line of I.R.S. precedents, the mayor's plan for distributing money from the Twin Towers Fund appears to conflict with rules that specifically bar tax-exempt charities from giving money to individuals who are not in demonstrable financial distress.

And those lawyers said their conversations with the I.R.S. indicated the agency was not inclined, at least so far, to soften its position despite the magnitude of the human loss on Sept. 11.

Yesterday, city officials defended the mayor's plan to immediately distribute $40 million, saying that it complied with I.R.S. rules while honoring the wishes of millions of donors to reward the heroic sacrifices of so

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