

Tipping and the IRS Public Support Test

What is tipping?

“Tipping” occurs when a donor makes so large a grant to a publicly supported charity that the grantee fails the IRS public support test, is “tipped” out of public charity status and is reclassified by the IRS as a *private foundation*.

What are the consequences of being a private foundation?

Any organization that is tipped into private foundation status will be required to file a different tax return and will be subject to an excise tax on net investment income. Living donors will be more restricted in what portion of their gifts will be deductible as charitable contributions and scholarship programs will need to be approved in advance by the IRS.

Perhaps the biggest consequence is that the organization will not be eligible for grants from the Rasmuson Foundation as well as many other private foundations. Most private foundations will not make grants to other private foundations.

Why is the Rasmuson Foundation concerned about tipping?

Many public charities and their boards are not aware of the important requirements of meeting the public support test and the potential ramifications of being tipped. The Rasmuson Foundation does not want an organization to be unwittingly tipped as a result of one of its grants. This document has been prepared as an overview of the public support test and tipping.

What does the Rasmuson Foundation require applicants to do if it looks like tipping may be an issue?

If your organization is applying for a grant from the Rasmuson Foundation that is large enough to potentially tip your organization, you should seek guidance from a CPA or try to obtain an advance ruling from the IRS. A letter from a CPA (see attached example) or an advance ruling letter from the IRS stating tipping is not an issue should be attached to your grant application.

What is the public support test?

The IRS requires charities to demonstrate their level of public support through annual filing of Form 990. On Schedule A, Part IV -A, charities must prove that over the past four years they have received at least one-third of their total support in contributions from the general public. The proportion of this public support can drop as low as 10 percent of total support if the charity meets a facts-and-circumstances test that suggests it is trying to increase public support.

In the public support test calculation, the part of a grant or gift that exceeds 2 percent of an organization's total support (the sum of contributions, grants, earned income, contracts, etc) will not count towards the calculation of public support. A large grant can decrease the proportion of funds considered public support and put a charity into private foundation status.

The public support test is flexible and provides two chances to pass. The first test is called the "mechanical test" because it relies simply on a mathematical formula. If, during the period of calculation, the amount of public support equals or exceeds one-third of total eligible support, the organization will meet the test and will continue to qualify as a public charity.

Example:

Organization XYZ has received gifts and grants adding up to \$50,000 annually for the past four years. In addition they received \$60,000 in pull-tab income. The Rasmuson Foundation gives a grant of \$400,000. Does the organization pass the mechanical test? No.

To figure out why, you must first calculate the organization's *total support* which is the number on which the 2% limit on gifts is based. In this example, total support is \$660,000 and 2% of that number is \$13,200. Any grant that exceeds \$13,200 will be limited to \$13,200 when determining the public support amount.

Total support example

Gifts/Grants	\$200,000	\$50,000 in gifts and grants X four years
Other income	+ \$60,000	Pull tab revenue
Rasmuson Foundation	+ \$400,000	
Total support	= \$660,000	The sum of all fund sources
IRS Limit	X 2%	Multiply total support times 2% to determine the IRS defined limit on public support.
2% public support limit	= \$13,200	This number represents the maximum amount of any single gift or grant that can be included in the public support calculation below.

Look at the following example to determine how total public support is calculated. The \$400,000 grant exceeds the 2% limit of \$13,200 and is therefore capped at \$13,200. The \$60,000 pull-tab income is considered by the IRS to be unrelated to the mission of the organization and is not eligible for inclusion in the public support total. Total public support is \$213,200.

Public Support Example

Gifts/Grants	\$200,000	Total of all gifts and grants that fall below the 2% cap of \$13,200.
2% Limited gifts	+ \$13,200	The amount of the Rasmuson Foundation grant that can be applied to public support.
Total Public Support	= \$213,200	The sum of all eligible public support.

To determine whether the organization meets the mechanical test of 33 1/3% public support, divide public support by total support. In this example, the public support percentage is less than 33 1/3% and the organization fails the mechanical test.

Public Support Percentage

Public Support	\$213,200	Divide public support by total support
Total Support	\$660,000	
Public Support Percentage	32.3%	The IRS requires public support to be equal to or greater than 33 1/3% to pass the mechanical public support test.

If the organization fails to pass the mechanical test, there is a fallback test known as the “facts and circumstances test.” To qualify under this test, the organization must be able to demonstrate two elements:

1. The total amount of public support must equal or exceed an absolute minimum 10 percent of total support for the applicable period. In the case of Organization XYZ, it does.
2. The entity must be organized and operated to attract new and additional public support on a continuous basis.

In addition to meeting these two requirements, all pertinent “facts and circumstances” surrounding the operations of an organization will be taken into consideration in determining whether the test is sufficiently satisfied. Other factors include the percentage of public support, the diversity of the sources of support, how representative the governing body is, the availability of public facilities or services, and/or the level of public participation in programs or policies.

Unusual Grants

The IRS can also view a grant or gift as “unusual” in which case the gift or grant will be excluded from the calculation of total support. (See IRS Publication 557) The exclusion of unusual grants from the four-year test period provides a high degree of flexibility in dealing with unexpected or unusually large donations that might otherwise result in an organization being reclassified as a private foundation.

Generally a grant is deemed unusual if it:

1. is a substantial contribution or bequest from a person with no connection to the organization,
2. was attracted by reason of the publicly supported nature of the organization,
3. is unusual or unexpected with respect to amount, and
4. would, by reason of its amount, result in the organization not meeting the applicable public support test.

Whether a particular contribution satisfies these criteria depends on all the facts and circumstances.

Using the Organization XYZ example, see how excluding the Rasmuson Foundation grant creates a very different result when calculating total support, public support, and public support percentage. Organization XYZ now passes the public support test because its public support percentage exceeds 33 1/3%.

Total support example

Gifts/Grants	\$200,000	\$50,000 in gifts and grants X four years
Other income	+ \$60,000	Pull tab revenue
Rasmuson Foundation	0	This grant is excluded as an unusual gift in this example.
Total support	= \$260,000	The sum of all fund sources
IRS Limit	X 2%	Multiply total support times 2% to determine the IRS defined limit on public support.
2% public support limit	= \$5,200	This number represents the maximum amount of any single gift or grant that can be included in the public support calculation below.

Public Support Example

Gifts/Grants	\$200,000	Total of all gifts and grants that fall below the 2% cap of \$5,200.
2% Limited gifts	0	The Rasmuson Foundation grant is excluded as an unusual grant.
Total Public Support	\$200,000	The sum of all eligible public support.

Public Support Percentage

Public Support	\$200,000	Divide public support by total support
Total Support	\$260,000	
Public Support Percentage	76.9%	The IRS requires public support to be equal to or greater than 33 1/3% to pass the mechanical public support test.

If an organization believes a donation it is about to receive will qualify as an unusual grant, it can request an advance ruling from the IRS to pre-approve the donation as an unusual grant by issuing a determination letter. To do this, send all information necessary to make a determination on the status of a donation as an unusual grant to IRS, EP/EO Determination Processing, PO Box 19, Covington, KY 41012-0192.