How to Apply the "Public Support" Test for Your Tax-Exempt Organization

A Bite-Sized Legal Guide

Who should use this guide: Anyone running a tax-exempt nonprofit organization or considering starting one.

Public Charities vs. Private Foundations

Every tax-exempt organization (or "501(c)(3)") is further classified by the IRS as either a private foundation or a public charity.[1] Private foundations and public charities are distinguished primarily by their level of financial support from the general public and the level of public involvement in their activities.

Why does the distinction matter? Private foundations are subject to more stringent operating restrictions by the IRS and potentially to excise taxes if they fail to comply with those restrictions.[2] Also, the tax rules are less favorable for donations to private foundations, and there are other disadvantages to private foundation status.

How can we ensure we are classified as a public charity? A tax-exempt organization will be treated as a private foundation unless it is able to establish that it (1) reasonably expects to satisfy the requirements for classification as a public charity when it files its Form 1023 (Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code) and (2) in fact satisfies the requirements going forward. There are a few different ways you can satisfy these requirements:

- Churches, schools, hospitals, medical research organizations, and certain supporting organizations may qualify **automatically** as public charities.[3]
- Most other organizations need to meet either a **safe harbor test** or a **facts and circumstances test (the "public support tests")** to qualify as public charities.[4]

[1] *What is the difference between a private foundation and a public charity?* Internal Revenue Service https://www.irs.gov/charities-non-profits/eo-operational-requirements-private-foundations-and-public-charities
[2] For further detail on the restrictions and accompanying excise taxes, please see *Life Cycle of a Private Foundation – Ongoing Compliance*, Internal Revenue Services, https://www.irs.gov/charities-non-profits/private-foundations/life-cycle-of-a-private-foundation-ongoing-compliance, and *Private Foundation Rules*, the Nonprofit Law Group, https://nonprofitlawblog.com/private-foundation-rules/
[3] IRC §509(a)(1).
[4] IRC §509(a)(1).

  - Both public support tests are calculated **over a rolling 5-year period** (the current year and previous four years), and, if met, provide publicly supported status for the current year *and* the following year.
  - After providing more detail on what counts as "public support," we illustrate the tests below with some simple examples. In practice, these tests are very complicated, so it's critical to ensure you are prepared to **maintain the necessary records**, run the requisite computations periodically, plan and implement your fundraising to meet the tests, and, if necessary, line up the right professionals to help you do all of those things.
- Certain organizations that do not meet the public support tests might still be able to qualify as public charities if they are primarily supported through **income they earn from conducting their exempt activities**.[5] Very generally, to qualify, at least ⅓ of their total support must come from donations, membership fees, and revenues from their exempt-purpose goods or services, and no more than ⅓ of their total support can come from "investment income". A detailed discussion of this test is beyond the scope of this guide.

The Safe Harbor Test

Passing the safe harbor test requires that the exempt organization shows that at least one-third (33.33%) of its support comes from a broad group of supporters ("**public support**"), and **not just one, or a small number of, individuals or businesses**.

In other words, the total dollar value of donations that qualify as "public support" during the test period is divided by the dollar value of the "**total support"** the organization receives during the test period— we refer to this as the "**support fraction**." If the support fraction is 1/3rd or more, then the organization will qualify as a public charity. Thus, to be a public charity under the safe harbor test:

$$\frac{Public\ Support}{Total\ Support} \geq \frac{1}{3}(Total\ Support)$$

[5] IRC §509(a)(2).

What kinds of donations qualify as "public support" and "total support"?

Included in "Public Support" (numerator)	Included in "Total Support" (denominator)
Donations from federal, state, or local government*	All public support
Donations from another publicly supported charity*	
Membership fees, if the basic purpose of those fees is general support of the organization.[6]	
Donations from individuals or organizations not listed above (such as businesses or private foundations) **up to 2% of total support**[7]	All donations from individuals or organizations not listed above (such as businesses or private foundations)
	Net income from an unrelated business and investment income from an endowment or other assets held by the organization[8]

**Unless the government or publicly supported charity is merely passing through a donation that was earmarked by another donor*

What is not included in "public support" or "total support"?

- Exempt function or "gross receipts" income (including some membership fees or grants for services), unusual grants, voluntary services, and capital gains are excluded from the support fraction altogether.
- "**Unusual grants**" are excluded from both the numerator and denominator of the support fraction, and are not subject to the 2% limitation.[9]
    - An unusual grant is a donation, generally from a disinterested party (not involved with or related to the organization), that:
        - Is **attracted by the publicly supported nature** of the organization;
        - Is **unusual or unexpected** in amount; or

[6] *IRS Publication 557*, Internal Revenue Services, p. 35 www.irs.gov/pub/irs-pdf/p557.pdf
[7] To determine the proportion of donations from a given donor that can be counted as public support, multiply the organization's total support during the test period by 0.02. That is the total amount that can be counted as public support from a single donor (and their relatives or affiliated entities). Any amount above that must be counted as total support, but not as public support. Note that the 2% limitation applies on the same rolling basis as the public support tests, so a donor's status could shift over time.
[8] *IRS Publication 557*, Internal Revenue Services, p. 36 www.irs.gov/pub/irs-pdf/p557.pdf. Certain governmental services, facilities and tax revenues provided to the organization also are in this category.
[9] *IRS Publication 557*, Internal Revenue Services, p. 36 www.irs.gov/pub/irs-pdf/p557.pdf

        - Would adversely affect, because of its size, **the status of the organization as normally being publicly supported**. (The organization **must otherwise meet the public support test** in that year without benefit of the grant or contribution.)
    - For example, suppose an organization is usually supported entirely by small donations from the community. If it receives an unexpectedly large donation from a member of the public who is impressed with the organization's community engagement, it may be able to exclude that donation from the calculation if the donation otherwise would cause it to no longer qualify as a public charity.

The Facts and Circumstances Test

If an exempt organization fails to satisfy the safe harbor test, it may still qualify as a publicly supported organization (and therefore as a public charity) under the "facts and circumstances" test. To qualify, the organization **must satisfy all three** of the following requirements:

1. Must normally receive **at least 10% public support** (calculated in the same manner as in the safe harbor test); **<u>and</u>**
2. Must demonstrate **that it is operated in a manner that will attract public support**: it has a continuous and real program for soliciting donations from the general public, or it carries on activities designed to attract such support; **<u>and</u>**
3. Must be **in the nature of a publicly supported organization**, which is determined based on all relevant facts and circumstances, including the following:
    - The **percentage of public support** received (the higher above the 10% minimum, the more likely it is to be a public charity).
    - A **trending increase** in public support.
    - Significant **government support**.
    - The **breadth of an organization's support** (the number of donors, and whether the donors are a representative number of persons).
    - Whether **the governing board is representative of the broad interests of the public** as opposed to private interests. This can be demonstrated by having **board members** who are government officials, persons with expertise related to the organization's activities, and community leaders.
    - Whether the organization provides facilities or services **directly for the benefit of the general public on a continuing basis** or has **a high degree of participation from members of the public with expertise**, government officials or community leaders, or **conducts activities in the community**.

Timing for the Public Support Tests

The tests are calculated **over a rolling 5-year period.** In other words, to determine whether an organization can be considered publicly supported for a particular tax year (for example, 2022), the IRS will consider the aggregate level of public support received **during the tax year in question plus the preceding four years** (in our example, 2018 through and including 2022). If the test is met for a tax year, the organization also is considered publicly supported for the following tax year (sticking with our example, 2023).

For example, this organization would qualify as publicly supported in 2022 and 2023:

	2018	**2019**	**2020**	**2021**	**2022**	**5-year Average**
Public Support	$100,000	$100,000	$200,000	$50,000	$100,000	*550,000*
Total Support	$300,000	$300,000	$300,000	$300,000	$300,000	*1,500,000*
Support Fraction	1/3	1/3	2/3	1/6	1/3	*>1/3 (~37%)*

A new organization (e.g., an organization with less than a 5-year operating history) can qualify as a public charity if **it can demonstrate that it will reasonably be expected to meet the safe harbor test** or **the facts and circumstances test** during its first five years. Starting in an organization's 6th year, and for every year afterward, it must show that it actually passes the public support test

Example of the Five Year Test Period

Below, we have highly simplified examples that walk through how the safe harbor test would be calculated over the first five years of a nonprofit's life. In these examples, the nonprofit will receive $300,000 over its first five years. To meet the safe harbor test, at least $100,000 must have come from "public support," as defined above. For donations from people or organizations other than publicly supported charities or government, **up to $6,000 will be counted as public support** (2% of $300,000).

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Example 1: Safe harbor is met.

	Public Support	Total Support
Donations from individuals, each gift is less than $6,000	$50,000	$50,000
One-time $10,000 donation from Business A	$6,000	$10,000
One-time $50,000 governmental grant	$50,000	$50,000
Net income from an unrelated business and investment income	$0	$190,000
Total	$106,000	$300,000

Here, the donation from business A is subject to the 2% limitation, so only the amount representing 2% of total support counts as public support, though the entire donation counts towards the total support denominator. On the other hand, government grants are not subject to the 2% limit, so the entire amount is included as public support. Income that the nonprofit generates from unrelated business activities and investments do not count as public support, but do increase the total support denominator. Over the course of the 5-year test period, about 35% of the nonprofit's total support counts as public support, so the safe harbor is met.

Example 2: Safe harbor is not met.

	Public Support	Total Support
Donations from individuals, each gift is less than $6,000	$50,000	$50,000
One-time $50,000 donation from Private Foundation A	$6,000	$50,000
One-time $10,000 governmental grant	$10,000	$10,000

Net income from an unrelated business and investment income	$0	$190,000
Total	$66,000	$300,000

As above, the donation from Private Foundation A is subject to the 2% limitation. As a result, a significant portion of that donation is not treated as public support (assuming for purposes of this example that this donation does not constitute an "unusual grant"). Over the course of the 5-year period, 22% of the organization's total support counts as public support, so the safe harbor is not met. However, because more than 10% of the organization's total support is public support, the organization may still qualify as a publicly supported organization under the "facts and circumstances" test, depending on the factors described above.[10]

Takeaways

This guide is intended to serve as a simple introduction to the public support tests. It should not be relied upon as complete information with respect to any matter discussed, nor does it set out a list of responsibilities that apply to public charities.

The application of the public support tests can be incredibly complex. In addition, this is just one of many requirements that apply to 501(c)(3) organizations. If you have not already done so, it is important to engage a professional (e.g., accountant experienced with tax-exempt organizations) to assist you with accounting and compliance requirements.

More Resources

- IRS Publication 557

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[10] Some organizations are able to qualify as public charities through an alternative test (based on Section 509(a)(2)) or based upon their relationship as a "supporting organization" of another qualifying public charity (Section 509(a)(3)), but discussions of these rules are beyond the scope of this guide.