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IRS ISSUES

The "Unusual Grant Exception" Can Save the Day

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A recent post, *Tipping Out of Public-Charity Status* (August 16, 2023), is a reminder that 501(c)(3) organizations that are (publicly supported) public charities "must keep a watchful eye on revenue throughout each and every year." It's not enough to check up on it haphazardly from time to time or after-the-fact when the Form 990 information returns are signed and ready to file.

Qualifying for this highly coveted tax status is not a "one and done" situation. It's subject to change, based on financial information from the current and past four years. Making the cut – (based on meeting either of two mathematical formulas, softened by some wiggle room based on "facts and circumstances") – is a snapshot in time.

"If a public charity "fails to meet the IRS public support test requirements for two consecutive years it risks losing its status as a public charity— this is referred to as tipping."

"A key financial danger lurking for any 'publicly supported' organization," we emphasized in the August 16th post, is that the organization "may 'tip' out of the highly preferred public charity status – inadvertently or not – and into the less favored and more onerous private foundation category."

Consider a different scenario: What if – instead of *accidentally* "tipping" just a bit out of the highly coveted public-charity status – a large and unexpected grant, gift, or bequest crash lands at that organization's front door?

Does this ordinarily very good news necessarily morph into big trouble?

Maybe not. There's an official exception for "unusual grants" that may well save the day in many situations.

Unusual Grants – Generally

"Publicly supported charities must demonstrate that they continually meet a minimum threshold of public support over a 5-year reporting period. A single substantial and material change in revenue" can trigger the loss of that desirable status, triggering reversion to private-foundation classification. "This is called 'tipping.'" See *Tipping from Public Charity to Private Foundation Status* (January 11, 2018) *ngosource.org*.

But one way to avoid a catastrophic result is for that organization to establish it "was the recipient of a material and unexpected contribution that qualifies as an 'unusual grant' under U.S. Treasury Regulations Section 1.509(a)-3(c)(3)."

See also: *Decoding the Public Support Test: How the IRS Distinguishes Public Charities from Private Foundations* (July 24, 2023) Jack Salmon, Philanthropy Roundtable. Sometimes "tipping" occurs "when an organization, normally set up to seek and attract broad public support, unexpectedly receives a big chunk of money from a single source...." That generosity can throw the numerator of the recipient-organization's public-support fraction into dangerous levels of ineligibility.

For example, "a public charity with $1,000,000 in revenue that typically receives half ($500,000) of its funding through 'public support' would tip below the 33-1/3 public support threshold if it received a large grant of $600,000 from a private foundation for two consecutive years. Unless the public charity can prove through the facts and circumstances test that it normally receives a substantial part of its support from the general public or government grants, the organization would risk being reclassified as a private foundation."

In *From Public Charity to Private Foundation: How to Handle the "Tipping" Problem* (September/October 2018) 25 *Taxation of Exempts,* Thomson Reuters, Vol. 30, No. 2, Christopher Hammond, Esq. points out: "The unusual grant exclusion is a powerful tool in avoiding a tipping problem .... Many publicly supported public charities first encounter a tipping threat as a result of a large bequest from a generous community member or a disproportionately large grant from a well-intentioned philanthropist or private foundation. When the facts and circumstances suggest that the receipt is not 'normal' for public support purposes, the organization entirely excludes the receipt (i.e., it does not factor into the public support test)." See *Treasury Reg. 1.170A-9(f)(6)(ii)(A)*.

And in *Public Support Tests – Unusual Grants* (January 16, 2006), *Nonprofit Law Blog*, attorney Gene Takagi explains: "In applying the 2% limit to determine whether (1) the One-Third Support Test or (2) the Ten-Percent-of-Support Requirement of the Facts and Circumstances Test is met, unusual grants are excluded from both the numerator and denominator of the appropriate percent-of-support fraction."

Factors Considered

In *Unusual Grants* (February 6, 2018), *ngosource.org*, a nonprofit consulting firm explains that an "unusual grant is a substantial and material contribution or bequest from a disinterested party that meets a combination of factors set forth in" the treasury regulations. "If a contribution or bequest qualifies as an unusual grant, it can be excluded from both the numerator and the denominator of the public support calculation and thereby prevent the organization's public support from dipping below the required threshold."

The NGOSource authors add: "The unusual grant exception applies to contributions or bequests from disinterested parties, where such contributions or bequests satisfy all three of the following criteria:

- They are attracted by reason of the publicly supported nature of the organization;
- They are unusual or unexpected with respect to the amount thereof; and
- They would, by reason of their size, adversely affect the status of the organization as normally being publicly supported."

But "[n]o single factor is determinative in evaluating whether a particular contribution qualifies as an unusual grant. Instead, all pertinent facts and circumstances are taken into consideration. Factors considered include –

- The relationship of the contributor to the organization. Persons other than those who created the organization, previously contributed a substantial part of its support or endowment, or stood in a position of authority, such as a foundation manager, will ordinarily be given more favorable consideration.
- Whether the contribution was a bequest or an inter vivos transfer. A bequest will ordinarily be given more favorable consideration than an inter vivos transfer.
- Whether the contribution was in the form of cash, readily marketable securities, or assets that further the exempt purposes of the organization, such as the gift of a painting to a museum.
- Whether, prior to the receipt of the contribution, the organization carried on an actual program of public solicitation and exempt activities and was able to attract a significant amount of public support — except in the case of a new organization.
- Whether the organization may reasonably be expected to attract a significant amount of public support subsequent to the contribution.
- Whether, prior to the year in which the contribution was received, the organization met the public support test without the benefit of any unusual grant exclusions.
- Whether the contributor, or any "disqualified person" in relation to the contributor — such as a family member, controlled entity, or a substantial contributor to the contributor — directly or indirectly exercises control over the organization.
- Whether the organization has a representative governing body.
- Whether material restrictions or conditions have been imposed in connection with the contribution."

Stay Exempt!

Even if these topics – the public-support tests and the unusual grant exception – are not entirely new to you, it's a lot to take in all at once, notwithstanding our generous peppering of this post and last week's with abundant reference links.

Along to the rescue come the Exempt Organizations folks at the Internal Revenue Service with a special cartoon-hosted overview course from the popular "Stay Exempt" podcast series. In *The Wonderful World of Foundation Classification 509(a)(1) & 509(a)(2)*, there are 23 individual segments of lively sound animation, each with a one-page slide of text. It's about 20-25 minutes long. There's also a downloadable PDF transcript of the podcast.

This episode opens with the threshold query: "Why does our foundation status matter? Aren't all 501(c)(3) organizations the same?" It continues through the mechanics of how to apply the public-support mathematical tests and concludes with an overview of the "unusual grant" exception.

Conclusion

This Stay Exempt! Podcast is an excellent introduction to these important topics for EO novices and a valuable review for the rest of us.

Sadly, our favorite cartoon host, the always delightful Legal, the Stay-Exempt Eagle, is missing for undisclosed reasons.

Nevertheless, we are ably guided by Coach, the "knowledgeable, straight-talking IRS Revenue Agent from the website, StayExempt.org." The discussion moves along briskly through helpful questions and comments interjected by Bert, Dakota, and Grace, "some EO representatives at a nonprofit tax law clinic."

And Coach is so cool that he softens the blow of referring to specific legal authority by prefacing it with: "I hate to go all bureaucratic on you, but I need to mention a couple of Internal Revenue Code sections to help us keep things straight…."

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