

## Tipping Out of Public-Charity Status

08.16.23 | Linda J. Rosenthal, JD



There's a timely reminder, in a recent "Policy Primer" from Philanthropy Roundtable, that the vast majority of 501(c)(3) organizations that are (publicly supported) public charities must keep a watchful eye on revenue throughout each and every year. See [Decoding the Public Support Test: How the IRS Distinguishes Public Charities from Private Foundations](#) (July 24, 2023) Jack Salmon, Philanthropy Roundtable.

A key financial danger lurking for any "publicly supported" organization is that it may "tip" out of the [highly preferred public charity status](#) – inadvertently or not – and into the less favored and [more onerous private foundation](#) category.

### ***The Public Support Tests***

"A Section 501(c)(3) organization can avoid private foundation status, and thus be classified as a public charity, in [any of three ways](#): (1) by being a certain kind of institution, such as a church, school, or hospital; (2) by meeting one of two mathematical public support tests; or (3) by qualifying as a supporting organization to another public charity."

The [majority of the nation's public charities](#) rely on the second route; namely, meeting one of two (alternative) public-support mathematical calculations.

There are many published resources on how to calculate these tricky math formulas, including the official ones from the government: see [Publication 557](#), Tax Exempt Status for Your Organization (Rev. 2023), pp. 33-41. A bit easier to read is [An Introduction to Public Support Tests](#) (May 30, 2017) [ngosource.org](#). See also, Philanthropy Roundtable's [July 24th publication](#) as well as [Qualifying for Public Charity Status: The Section 170\(b\)\(1\)\(A\)\(vi\) and 509\(a\)\(1\) Test and the Section 509\(a\)\(2\) Test](#), Adler & Colvin.

***"Nothing is Forever"***

There's a huge caveat: Public charity status (via the public-support route) is not necessarily forever.

"The public support test is based on a five-year computation period; that is, the current year and the four years immediately preceding the current year. "Publicly supported charities must demonstrate that they continually meet a minimum threshold of public support over [that] 5-year reporting period." If that math works out, then the public-charity status will hold for the current year and the next one.

A new organization is assigned public-charity status "if it can show that it reasonably can be expected to be publicly supported," through attestations and financial and other information in the tax-exemption application. See See IRS Form 1023 and Form 1023-EZ. "If the IRS classifies the nonprofit as a public charity, it keeps this status for its first five years, regardless of the public support it actually receives during this time."

Of course, starting with the 501(c)(3)'s sixth tax year, "it must show that it meets the public support test, which is based on the support it receives during the current year and previous four years. The nonprofit must file Schedule A along with its annual information return on Form 990 or 990-EZ, containing detailed information about its sources of financial support. If a nonprofit passes the test, the IRS will continue to monitor its public charity status after the first five years by requiring that a completed Schedule A be filed each year."

Qualifying as a public charity via the public-support tests route is not in any way guaranteed; indeed, a "single substantial and material change in the income of a publicly supported charity can cause the organization to lose its public charity status and convert to a private foundation. This is called 'tipping.'"

#### *About Tipping*

"By default, once a public charity tips, it becomes a private foundation and loses the benefits associated with its former classification as a public charity. In the U.S., broadly speaking, this means more restrictions on its activities and expenditures, as well as lower limits on deductions from donors. For foreign public charity equivalents, it means that grantmakers — private foundations and donor advised funds — must exercise expenditure responsibility when making grants to them."

In Exempt Organizations Annual Reporting Requirements – Form 990, Schedules A and B: Maintaining Public Charity Status, the government explains: "An organization will lose its public charity status if it cannot pass the public support test for two consecutive years." In that case, "it will be reclassified as a private foundation as of the start of the second consecutive year (unless it qualifies as another kind of public charity)."

The government offers a response to the hypothetical query: "What can I do to help ensure that my organization does not unexpectedly lose its public charity classification?" The succinct answer: "To avoid unexpectedly losing your public charity classification, you should keep careful track of your public support information throughout the year instead of waiting until the end of the tax year when you are preparing your Schedule A."

Happily, there's additional explanation and fulsome advice from a variety of other sources about tipping issues.

See, for example, these helpful articles and publications:

- [Tipping from Public Charity to Private Foundation Status](#), (January 11, 2018) [ngosource.org](http://ngosource.org)
- [Decoding the Public Support Test: How the IRS Distinguishes Public Charities from Private Foundations](#) (July 24, 2023) Jack Salmon, Philanthropy Roundtable – section titled “Public Support and the Risk of Tipping.”
- [From Public Charity to Private Foundation: How to Handle the “Tipping” Problem](#) (September/October 2018) Christopher M. Hammond, Esq., 25 *Taxation of Exempts*, Thomson Reuters, Vol. 30, No. 2.

Among the topics covered are:

- Common causes of tipping
- Tipping warning signs
- Why small public charities are at particular risk
- How to avoid the risk of tipping
- How grant makers can avoid tipping grantees
- Tipping examples
- Options if tipping is possible or likely
- Notifying the IRS

#### ***Conclusion***

The key takeaway from all of these experts is to maintain diligence – not just at or near the end of a fiscal year. For many reasons, the organization may not know for sure about its public charity status for any particular tax year until it makes the necessary calculations at the end of that year.

Accordingly, the monitoring of public support (and planning for it) should be done regularly over the months of each fiscal period.

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