



NONPROFITS: INTERNAL REVENUE SERVICE

## What to Do With an Unusual Grant

09.26.17 | Linda J. Rosenthal, JD



Imagine a scene like this: A small group of people is celebrating the receipt that day of an IRS Determination Letter granting 501(c)(3), tax-exempt, status for their new community organization. They are still at the “sitting around a dinner table” stage because there hasn’t been time or the funds to set up office space. On the agenda for that evening is crafting a fundraising strategy to attract financial support from the community. Preliminary discussions with friends, neighbors, and colleagues have been encouraging.

Suddenly, there’s a knock at the door. It’s a stranger who’s heard about the program and likes the idea. He drops a big bag of cash on the table.

That’s a fairy tale, right? It would never happen.

Well, occasionally, it *does* happen. Money falls out of the sky unexpectedly.

How can that be anything but good news? Here’s how: The new nonprofit is classified as a “public charity.” That means it enjoys more benefits than a “[private foundation](#)” which is subject to stricter operating rules and restrictions. To continue to be eligible for the more favorable status, this group must show the IRS it is set up to solicit and receive broad-based public support. There are mathematical formulas to meet or exceed. This enormous donation from the generous stranger – while welcome and needed – will likely skew the delicately balanced numerators and denominators in a negative way.

If only there were a way to treat this unexpected windfall as what it is: unusual. Happily, there *is* a way: an exception to these math formulas for “unusual grants.” To take advantage of this loophole, the 501(c)(3) public charity must file [IRS Form 8940, Request for Miscellaneous Determination](#), along with enough supporting documentation and explanation to show the intention to aggressively hunt down broad-based support from the general public – despite the serendipitous appearance of the



generous gift.

## *Public Charities and an Unusual Grant*

The official rules about public-charity status and the “unusual grant” exception are explained at Internal Revenue Code [section 509\(a\)\(1\)](#) and Treasury Regulations [section 1.170A-9\(f\)\(6\)\(ii\)](#). To help slice through this legal gobbledygook, there’s IRS [Publication 557](#), “[Tax Exempt Status for Your Organization](#).” The explanation of the requirements for public charity status, including the dreaded mathematical formulas, begins at page 30. The discussion narrows to the “unusual grants” exception at pages 35-36 and includes a few examples.

Helpful, also, is Private Letter Ruling [201701023](#) from the IRS to a 501(c)(3) formed to “enhance and support the work of law enforcement officers across the country through educational, direct assistance, and community outreach programs.” While private rulings like these apply only to the applicant-organization, they give useful guidance on how to pass the “unusual grant” test to enjoy the fruits of a lucky dose of much-needed, but unexpected, funds.

The law-enforcement support nonprofit in PLR 201701023 had just started, but was already “actively engaged in seeking sources of funding.” A philanthropist – unaffiliated in any way, and sharing the interests in education and national security – was told about it “through a mutual acquaintance.” He invited this new 501(c)(3) to apply for a grant.

The grantor approved the application, selecting this startup nonprofit “for a pilot program designed to measure and remedy local police perception through media, community involvement and training.” The award was for “...cash, or equivalent, to be used for community, education, and media outreach, police recognition awards, and scholarships to attend police academies.” No conditions or restrictions applied beyond carrying out the grant terms.

In the private letter ruling, the IRS points out the factors tending to show that this organization is set up “...to attract significant and broad public support”:

”

---

*...[Y]our [independent] Board of Directors includes two veteran law enforcement officers with extensive experience and networks of contacts in the law enforcement community, an experienced business executive with strong ties to business, religious, and political communities that has public sector senior management experience, and a founder/executive director of a separate public charity that combats global poverty. In addition, you plan to establish a website to publicize your programs as well as accept contributions. You also intend to apply for grants from government agencies, public charities, and private foundations. Furthermore, public outreach and educational initiatives will be a significant portion of your charitable activities.*



The only downside to this useful procedure is that it took some 15 months or so for this charity's Form 8940 to make its way through the IRS bureaucracy.