Qualifying for Public Charity Status as a “Publicly Supported Organizations”

Non-profit organizations that qualify for federal income tax exemption under Section 501(c)(3) of the Internal Revenue Code (“Section 501(c)(3) organizations”) should be aware that each Section 501(c)(3) organization is further divided for federal income tax purposes into one of two categories: public charity or private foundation. Public charity status is generally the more advantageous characterization because private foundations are subject to more complex and restrictive laws and taxes than public charities. As a result, Section 501(c)(3) organizations generally seek to qualify as a public charity for federal income tax purposes.

A Section 501(c)(3) organization can qualify as public charity in one of the following three ways: (a) by organizing as a certain legislatively designated type of institution, such as a hospital, school, or church, that automatically qualifies as a public charity; (b) by organizing as a “supporting organization” of another public charity or charities, thereby obtaining public charity status based solely upon establishing a close structural relationship with another public charity or charities; (c) or by qualifying as a “publicly supported organization” by satisfying one of the two public support tests described in: (1) Sections 509(a)(1) and 170(b)(1)(A)(vi), and (2) Section 509(a)(2) on an ongoing basis. This article summarizes the two public support tests that may be met in order for a Section 501(c)(3) organization to qualify as a publicly supported organization.

Public Support Test under Sections 509(a)(1) and 170(b)(1)(A)(vi)

Generally, the test under Sections 509(a)(1) and 170(b)(1)(A)(vi) requires that, during each five-year period, a substantial portion of the organization’s total support throughout the five-year period comes from “public support”. This test is conducted on an annual basis and examines the support received by the organization during the current tax year and the four prior tax years. In order to maintain public charity status, the organization must pass this public support test each year.

Public support, for purposes of the test under Section 509(a)(1) and 170(b)(1)(A)(vi), generally includes grants from governmental agencies, contributions from the general public, and contributions or grants from other public charities. Public support excludes the portion of total contributions made by each person during the five year period that exceeds 2% of the total support the organization receives in the five years. This 2% limitation does not apply to contributions from governmental units and from other public supported organizations. In addition, in some limited circumstances, an unexpectedly large grant may be excluded as public support.

The test under Sections 509(a)(1) and 170(b)(1)(A)(vi) uses a mathematical fraction computation to determine the portion of the organization’s total support that comes from public support. The amount of the public support throughout the five year testing period (the numerator) is divided by the total support received by the organization throughout the five year testing period (the denominator). If the resulting
percentage is 33 1/3% or greater, the public support test under Sections 509(a)(1) and 170(b)(1)(A)(vi) is satisfied and the organization will qualify as a publicly supported organization.

If the calculated percentage is less than 33 1/3% but is 10% or more, the organization may still qualify as a publicly supported organization if it meets a “facts and circumstances test”. To satisfy the facts and circumstances test, the organization must be organized and operated as to attract new and additional public or governmental support on a continuous basis. This requirement will be considered met if the organization maintains a continuous and bona fide program for solicitation of funds from the general public, or if it carries on activities designed to attract support from governmental units or other public organizations. In addition, all the following relevant factors will be considered:

- Percentage of financial support. The higher the percentage of public support, the lower the burden for satisfying the other factors listed below;
- Source of Support. Whether the public support comes from governmental units, or from a large number of unrelated persons, rather than almost all of the support coming from a smaller and more interconnected group of individuals;
- Representative governing body. Whether the organization’s governing body represents the broad interests of the public, rather than representing the private interests of a limited number of persons;
- Availability of public facilities or services; public participation in programs or policies. Whether an organization generally provides facilities or services directly for the benefit of the general public on a continuing basis;
- Additional factors pertinent to membership organizations. Several factors are to be considered in determining whether a membership organization is “publicly supported”, including: (1) whether the dues-paying members are solicited from a substantial number of persons in the community; (2) whether the membership dues for individuals are designed to make membership available to a broad section of the interested public, rather than to a limited number of persons; and (3) whether the activities of the organizations will likely appeal to persons having some broad common interest or purpose.

**Public Support Test under Sections 509(a)(2)**

The test under Section 509(a)(2) requires that an organization, during each five-year period receives, on an aggregate basis, more than 33 1/3% of its support from public support. This test is conducted on an annual basis and examines the support received by the organization during the current tax year and the four prior tax years. In order to maintain public charity status, the organization must pass this public support test each year.

Public support, for purposes of the test under Section 509(a)(2), generally includes, contributions, grants, and membership dues received for general support of the organization, as well as fees received from the general public related to activities undertaken by the organization in furtherance of its tax-exempt purpose, including admissions, sales of merchandise, performance of services, and/or furnishing of
facilities. In addition, the organization can receive no more than 33 1/3% of its support from gross investment income and unrelated taxable income.

For purposes of the public support test under Section 509(a)(2), public support does not include any contributions, grants, membership dues, or other gross revenue received from “disqualified persons”. A disqualified person for this purpose, under Section 4946, includes:

- A substantial contributor, which is a person who gave an aggregate amount of more than $5,000, if that amount exceeds 2% of the total contributions the organization received since its inception.
- An officer, director, or trustee of the organization or any individual having powers or responsibilities similar to an officer, director, or trustee of the organization.
- A person who owns more than 20% of a corporation, a partnership, or a trust that is a substantial contributor to the organization.
- A family member of an individual in the first three categories, including the individual’s spouse, ancestors, children, grandchildren, great-grandchildren, and the spouses of children, grandchildren, and great-grandchildren.
- A corporation, a partnership, a trust, or an estate in which a person described in the first four categories owns more than 35% of the voting power, profit interest, or beneficial interest.

In addition, public support excludes the portion of fees annually received from non-disqualified persons from admissions, sales of merchandise, performance of services, and/or furnishing of facilities related to the organization’s tax-exempt purpose that exceeds the greater of $5,000 or 1% of the organization’s total support. Furthermore, in some limited circumstances, an unexpectedly large grant may be excluded as public support.

As noted above, this test utilizes two percentages to determine an organization’s public charity status. The first percentage is the organization’s public support percentage, which is calculated by dividing the organization’s five-year public support amount (the numerator) by its five-year total support amount (the denominator). The second percentage is the organization’s investment income percentage, which is calculated by dividing the organization’s five-year investment income and unrelated business taxable income (the numerator) by its five-year total support amount (the denominator). If the organization’s public support percentage is 33 1/3% or more, and its investment income percentage is less than 33 1/3%, the public support test will be satisfied and the organization will qualify as a public charity under the Section 509(a)(2).

Conclusion

One of the ways that a Section 501(c)(3) organization can qualify for public charity status is to meet one of the two public support tests described above. In particular, Section 501(c)(3) organizations that derive a significant portion of their revenue from donations may be able to qualify as a public charity pursuant to the public support test under Sections 509(a)(1) and Section 170(b)(1)(A)(vi). In addition, Section 501(c)(3) organizations that derive a significant portion of their revenue from undertaking program service
activities in furtherance of the organizations’ tax-exempt function may be able to qualify as a public charity pursuant to the public support test under Section 509(a)(2).

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