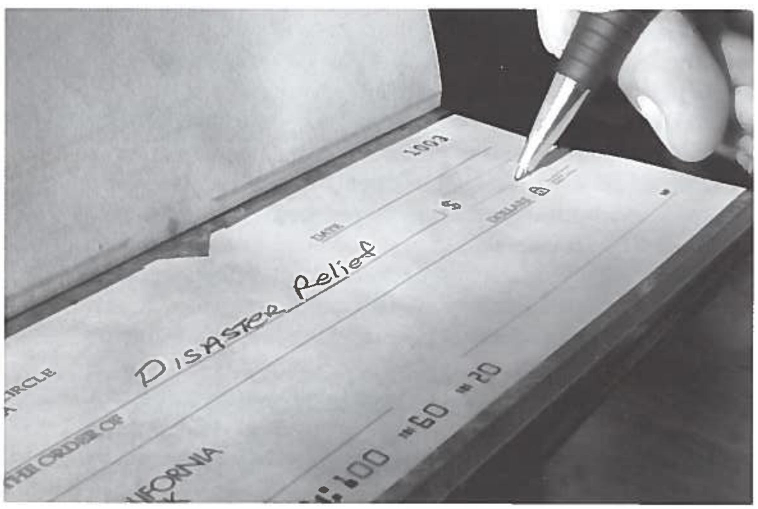
More Than Money

Most donors engage in 'checkbook philanthropy'

More than half of high net worth individuals plan to leave some of their fortunes to charity, according to a recent survey, and 9 of 10 are involved in some kind of philanthropy.

Millionaires typically give about 7 percent of their annual income to charity, and the majority will leave an average of 28 percent of their assets to charity when they pass away, the UBS Wealth Management Americas survey of 2,200 wealthy Americans found.

But the charities they choose for their donations are often selected haphazardly, chosen reactively upon request, the study found.



Only 9 percent plan their philanthropic giving, and almost one quarter decide how much they want to give as solicitations come in – "checkbook philanthropy."

Wealthier philanthropists – those with more than $5 million in assets – tend to be more satisfied with their gifts, the study discovered, because they strategically planned their philanthropy more than those with less wealth.

Overall, high net worth donors gave most to the less fortunate (55 percent), followed by religious organizations (42 percent) and medical organizations (41 percent).

Older donors tend to give to more traditional institutions like their alma maters and churches, while younger donors focus more on disease-fighting groups and children's organizations, the study found.

> Only 9 percent of wealthy donors plan their philanthropic giving. The charities they choose are often selected haphazardly, chosen reactively upon request.

The study also found that the wealthy get more satisfaction out of volunteering than giving money. Only 20 percent said they consider their financial gifts to be effective.

In another study of 300 wealth advisors and 120 high net worth individuals by U.S. Trust and the Philanthropic Initiative, advisors said it is important for wealthy donors to meet with advisors early on to create a plan for their philanthropic giving.

Yet only 55 percent of the donors surveyed said they discuss their donations with an advisor. Another 13 percent are open to discussions, and most say they do discuss their donations with a spouse, family

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Public Charity: *Does your organization pass the test?*

Second in a series of articles on Public Charities

by John Stancil, CPA, Steve Kelin, CPA, and Richard Locastro, CPA

To be a public charity, an organization must meet one of the Internal Revenue Code Section 509(a) tests.

This article focuses on the first listed test, Section 509(a)(1). The alternative 509(a)(2) test will be discussed in a future article.

509(a)(1) vs. 509(a)(2) Tests

Generally speaking, the public support tests under 509(a)(1) and (a)(2) are designed to make sure that a 501(c)(3) organization has a sufficiently broad base of support to be classified as a public charity and not a private foundation.

There are a number of benefits to qualifying as an (a)(1) organization rather than as an (a)(2) organization, including:

- In calculating public support, an (a)(1) organization only excludes excess contributions, as explained below, from substantial donors.
- There is an exception from the 2 percent cap, as explained below, for government and certain other 509(a)(1) donors.
- There is an alternative 10 percent "facts and circumstances" test, which acts as a safety net in achieving public charity status, but does not apply under 509(a)(2).
- There is no separate public charity calculation restriction on investment income.

509(a)(1) Test

The criteria for being a 509(a)(1) public charity are not included in Code Section 509(a)(1). 509(a)(1) simply refers to organizations described in Section 170(b)(1)(A)(i)-(vi).

Code Section 170(b)(1)(A)(i)-(v) includes subsections for churches, schools, hospitals and governmental units. These organizations are treated as public charities based upon the nature of the organizations' activities.

Section 170(b)(1)(A)(vi) determines public charity status based on an organization's sources of support. Going forward, we will refer to 509(a)(1) when describing these 170(b)(1)(A)(vi) entities.

There are two applicable tests under 509(a)(1). First, if the entity's public support is greater than 33.33 percent, it is automatically classified as a public charity. However, even if public support is less than 33.33 percent, it may still qualify as a public charity under the subjective 10 percent "facts and circumstances" test.

Because the 509(a)(1) test does not include fees from the performance of activities related to an organization's exempt purpose – referred to interchangeably as fees, fees for services, or gross receipts – in the support calculation, it is often necessary to first determine whether certain revenues, which may be labeled as "grants," are even included in the calculation.

To distinguish whether a grant is a contribution or a fee (and therefore excluded in the calculation), the regulations state that contributions confer no or limited benefit to the donor, while fees demonstrate a primary benefit to the donor.

A grant is defined as an amount given to an organization that is intended to encourage the grantee organization to carry on its exempt purpose. Fees, on the other hand, serve direct and immediate needs of the payor rather than conferring a benefit upon the general public. Fees would include sales or services, while a grant would be used specifically to help the organization in executing its exempt purpose or mission.

Thus, a grant could state that the recipient must produce 1 million educational booklets. If the booklets are then distributed by the charity to the general public, the primary benefit is to the non-grantor (the general public), and the revenues are considered to be contributions. If the booklets are to be delivered back to the grantor, who will then decide what to do with the booklets, then the primary benefit has been provided to the payor, and the revenues are treated as fees.

'Good' vs. 'Bad' Support

As noted above, fees are not included in either the numerator or denominator of the calculation. Described below is the treatment of contributions in computing the public support of a 509(a)(1) entity.

The testing period for the 509(a)(1) public support test is five years: the current filing year and the preceding four years. In determining whether an entity has sufficient "public support," the calculation requires that you identify those contributions that are not considered "good" support.

To arrive at the desired greater-than-33.33 percent threshold, only this "good" money goes into the numerator, while all contributions go into the denominator. The amount from a single donor received during the five-year testing period that exceeds 2 percent of the total support of an organization over the five-year period is not "good" money.

Importantly, the regulations provide that amounts from the U.S. government or political subdivisions (states, cities, etc.) and other 509(a)(1)/170(b)(1)(A)(vi) organizations are not subject to this 2 percent limit.

Assume that an organization had $50 million in support over a five-year test period. Two percent of that is $1 million. If an individual, corporation or private foundation donor gave $3.5 million over the testing period, all of the donor's contributions would go into the denominator, but only $1 million would be "good" money and included in the numerator.

Thus, large amounts from single donors can have a very significant negative impact on the percentage of public support. However, if the $3 million contribution came from a U.S. governmental unit or 509(a)(1) organization, the entire amount would be classified as good money.

Although the code and regulations specify domestic governments, Rev. Ruling 74-435 concludes that foreign government support to a foreign charity is treated as government support for the (a)(1) test.

It is unclear whether, based on the ability to exclude foreign government funding, excluding organizations made up of foreign governments, such as the United Nations or the World Bank, might be considered. But contributions from foreign charities appear to be subject to the 2 percent limit, unless there are treaty provisions providing otherwise.

This determination of public support is made on Part II of Schedule A of the Form 990. If Section C, line 14 (current year) or line 15 (prior year) is 33.33 percent or more, then the organization is deemed to have sufficient public support to be a public charity. Thus, an organization that passes the test in one year is considered a public charity for that year and the following year.

An organization may fail to qualify by not meeting the objective 33.33 percent public support test. In these instances, an organization may turn to the subjective "facts and circumstances" test to attempt to be qualified as a 509(a)(1) organization. ■

Public Charity: *Facts and circumstances may qualify*

Third in a series of articles on Public Charities

by John Stancil, CPA, Steve Kelin, CPA, and Richard Locastro, CPA

An organization must be able to pass an Internal Revenue Code test to be considered a public charity.

The purpose of the test is to help assure that a 501(c)(3) organization has sufficiently broad public support to be classified as a public charity rather than a private foundation.

A public charity may qualify as a 509(a)(1) or 509(a)(2) organization. Qualifying under the Section 509(a)(1) is preferable because the rules for qualifying are much less burdensome. Section 509(a)(1) benefits are discussed in the previous article in this series on public charities, which we strongly recommend readers revisit before reading this installment.

The criteria for being a 509(a)(1) public charity are found in Section 170(b)(1)(A)(i)-(vi). This code section includes subsections for churches, schools, hospitals and governmental units, which are treated as public charities based upon the nature of their activities. Most commonly, an organization will qualify as a 509(a)(1) organization under the public support test.

As was discussed in the prior article, the public support test is met if the organization's public support is greater than 33.33 percent. If an organization meets the criteria, it will be qualified automatically as a public charity.

However, support does not include fees from the performance of activities related to an organization's exempt purpose. Depending on the terms, a grant may or may not be included as support.

There is also "good" and "bad" support, which means that certain large gifts may not be counted as support under certain circumstances.

If the organization cannot qualify under the objective 33.33 percent test, it may still qualify as a public charity under the subjective "facts and circumstances" provisions.

Facts-and-Circumstances Test

A facts-and-circumstances test is a subjective test that measures both financial and nonfinancial factors. The objective portion of this test mandates that public support must be at least 10 percent and that the organization be organized to attract public support.

This would include continuous and bona fide programs designed for the solicitation of funds (including governmental funds).

There are five subjective factors listed below in terms of "favorable" factors:

- The closer to 33.33 percent the public support is
- A representative number of donors rather than a single or limited number of donors
- A representative governing body including public officials, subject matter experts, and community leaders
- Availability of public facilities or services along with public participation in programs of the organization
- Broad solicitation of revenue, members and programming by membership groups

Eligibility and Unusual Grants

509(a)(1) Test Eligibility

To qualify as a 509(a)(1) public charity, an organization must be eligible to use the 509(a)(1) test. To be eligible for the test, an entity must receive "more than an insubstantial amount" of its support from contributions.

"More than insubstantial" is not well-defined in the regulations. The sole example describes an entity with 1 percent of its revenue from contributions and concludes that the entity was not eligible to use the 509(a)(1) test because 1 percent was not deemed to be more than insubstantial.

Although there is no authoritative guideline, many practitioners use a 10 percent of revenue from contributions threshold for eligibility to use the 509(a)(1) test.

Unusual Grants

Because the receipt of a very large contribution can adversely – and significantly – impact an organization's public support percentage, the regulations provide for special treatment of "unusual grants." Where the rules apply, an unusual grant is excluded from both the numerator and denominator in the support calculation.

An unusual grant:

- Is attracted by the reason of the publicly supported nature of the organization
- Is not expected in terms of the amount of the gift
- Would adversely affect the public charity status due to its size

Unfavorable factors that may come into play in determining whether a gift meets these standards include:

- Whether the donor is the creator of the organization or has made previous substantial gifts to the organization
- If the contributor exercises control over the organization
- If there are material conditions/restrictions on the gift

Favorable factors include:

- The transfer is a bequest rather than a lifetime gift.
- It is in furtherance of the exempt purpose of the organization, such as donating a painting to a museum.
- The organization had previously conducted successful public solicitations and programming.
- There is a reasonable expectation to attract public support in future.
- There is a representative governing body.

Because there are less favorable tax consequences for a donation to a public foundation, a donor will often request written confirmation from the charity that the gift will not jeopardize its public charity status.

While not a procedure used regularly, a request can be made in advance of the gift for an IRS determination that a gift will qualify as an unusual grant.

Obviously, the road to maintaining status as a public charity has many hurdles. Both senior management and the board should understand the importance of maintaining public charity status and take steps to assure themselves and donors that the organization does not inadvertently lose its public charity status. ■

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Checkbook Philanthropy *continued from front*

member or friend.

When wealthy donors decide not to contribute to a particular charity, they say it is most often because:

- They fear their gift won't be used wisely.
- They lack knowledge about the charity or a connection to it.
- They are afraid of increased donation requests from others.

More than half of the donors in the UBS study said they prefer that their donations remain anonymous.

Wealthy donors in the U.S. Trust study said their reasons for making charitable contributions are:

- Being passionate about a cause
- Having a strong desire to give back
- Leaving a positive impact on society

Encouraging members of the next generation to be charitable was also cited as an important reason to give.

Advisors, on the other hand, said wealthy donors make charitable contributions:

- To reduce their taxes
- For religious or spiritual reasons
- To create a legacy

They choose not to give to a charity, the advisors said, because:

- They fear they won't have enough money for their heirs.
- They won't have enough money left for themselves.
- They don't consider themselves wealthy enough to give. ■