SUPPORT REQUIREMENTS FOR PSO'S AND FASO'S

Most of the organizations that are exempt as public charities (e.g., churches, schools, hospitals, etc.) are defined in terms of their purpose. PSOs and FASOs are defined in terms of where their financial support comes from.

The tests described in this chapter are extremely technical. Before you plunge into this chapter, you should review #8 and #9 on page 101. These sections describe groups that should clearly be PSOs and FASOs without having to get caught up in the details of this chapter.

The support requirements for PSOs differ from those for FASOs. Basically, they are as follows:

PSO – *An organization which normally receives a substantial part of its support from a governmental unit or from direct or indirect contributions from the general public.*

FASO – *An organization which normally receives more than one-third of its support from any combination of:*

- gifts, grants, contributions or membership fees, and
- gross receipts from related business activities;

and normally receives not more than one-third of its support from the sum of:

- gross investment income; and
- the amount of the unrelated business taxable income less the amount of the unrelated business income tax.

The words in these rules have very specific and sometimes unexpected meanings (for instance, you may be surprised to learn that "normally" means "over four years"). We'll explain the rules that have the most importance for exempt groups, and point out other areas that you should check further if they apply to your group.

In order to qualify as a public charity under these rules, you need to receive a certain percentage of your total support from "qualified sources." The percentage is determined by dividing your total support into the income from qualified sources. Thus, total support from all sources is the denominator of this fraction, and the income from certain qualified sources is the numerator.

First, we'll explain how to calculate your total support base, which will be the denominator of the fraction. Next, we'll talk about how to calculate your support from qualified sources (the numerator) and then the proper tests to apply for PSOs and then for FASOs. At the end of this chapter, there are some worksheets to help you in calculating how you come out on the support test.

$$\frac{\textbf{NUMERATOR} = \textbf{Qualified Support}}{\textbf{DENOMINATOR} = \textbf{Total Support Base}}$$

In several cases, the rules are too detailed to describe here, and we suggest you see an attorney if you think those rules affect you.

In order to qualify as a public charity under these rules, you need to receive a certain percentage of your total support from "qualified sources." Total support from all sources is the denominator of this fraction, and the income from certain qualified sources is the numerator.

HOW TO CALCULATE THE TOTAL SUPPORT BASE

The total support base (denominator) can come from five sources for PSOs, six for FASOs. These sources are:

1. Contributions, grants (excluding unusual grants, discussed on page 159), and membership fees;
2. Gross receipts from related business activities (NOT for PSOs; in most cases, PSOs can have this income, but don't have to count it in either the denominator or numerator);
3. Net income from unrelated business activity, whether or not such activities are carried on regularly as a trade or business;
4. Gross investment income;
5. Tax revenues levied by a government unit for the benefit of an organization and either paid to or expended on behalf of the organization;

6. The value of services or facilities furnished by a government unit to an organization without charge (unless furnished also to the general public without charge).

These six sources are explained below.

1. Contributions, Grants and Membership Fees.

Contributions: A contribution (or gift) occurs when money or property (or the use of property) is given to your group with nothing given by you in return or when what you give in return is worth less than the gift or contribution. In the latter situation, the amount of the contribution is usually the difference between its value and what is given in return. To figure out the value of the contribution, read IRS Publications #526 – Charitable Contributions and #561 – Determining the Value of Donated Property, which you can get free from the IRS. See Appendix 2.

Grants: Grants are made to organizations, often by governmental units and foundations, to make it possible for the group to operate programs which are part of carrying out its exempt purposes. When the government provides the money, it can be difficult to determine whether the government is funding an activity that will benefit the general public (for example, the government grants you money to rehabilitate low-income housing at no cost) or is really contracting for a benefit which the government receives (for example, the government pays an educational organization to train governmental employees in the principles of management and administration). Generally, the government imposes fewer restrictions on grants and is less likely to solicit for grantees. In the case of contracts, the money the organization receives is not a grant but is instead a payment for services. It is either gross receipts from related activities (see #2 below) or income from an unrelated business (see #3 below).

Membership Fee: Groups often have members: people who share a common goal or concern. Sometimes the organization charges a fee to each prospective member as a requirement for joining the group. Payment of a membership fee often entitles the member to certain benefits, such as receipt of a newsletter, the right to attend meetings, and the right to vote. The membership fee is usually used for the general support of the organization.

In some cases, what looks like a membership fee may be something else. If one class of members pays a greater membership fee than another class of members and does not receive any additional benefits, (e.g., individual member, $10; patron, $100), the difference is classified as a gift or contribution rather than a membership fee. Similarly, if the membership fee is really a ticket price to a performance or event or the price of merchandise or services which are sold to the general public, then the fee is not a membership fee but rather income from a related or unrelated business activity.

Caution: Remember that in Oregon members also have the right to vote for the Board. If you have members who pay dues but do not vote, review page 52 for how to handle this.

2. Gross Receipts from Related Business Activities

Receipts from related business activities may come from the following activities:

- Admissions;
- Sales of merchandise;
- Performance of services; or
- Furnishing of facilities.

This category counts gross receipts, not net receipts after expenses are paid. The activity must be related to the charitable, educational or other exempt purpose of the organization. (See Chapter 9 to determine what is related and what is unrelated business activity.)

This support source is usually counted only for the FASO formula, not for the PSO formula. This is an advantage for PSOs because this support is also counted in the numerator for FASOs but *only to a limited extent.* As you read on, you will see that this can make it difficult for a group to pass the required support test. PSOs don't have to count it in either the denominator or the numerator. The exception to this is if substantially all of your organization's support is from gross receipts from related activities and an insignificant amount comes from governmental units and the general public. If this is the case, you cannot qualify as a PSO.

3. Net Income from Unrelated Business Activities

It's important to know the difference between related and unrelated business activity for three reasons. First, if the activity is related, all the gross receipts are counted in the total support base for FASOs in #2 above. If it's unrelated, only the net income is counted (and probably the net loss). Second, net income from unrelated activities is counted in the support base for both FASOs and PSOs. PSOs will also have to be able to make this determination. Third, both FASOs and PSOs are subject to a tax on some unrelated business income, but not on gross receipts from related activities. Chapter 9 discusses the difference between related and unrelated business activities.

The net income from unrelated business activities is counted as support if the income comes from a trade or business and if the income is not substantially related to your exempt purpose. It does not matter whether the activity is carried on regularly or is sporadic. Note that this is a broader test than the test for determining if you must pay unrelated business income tax. (See Chapter 9). The unrelated business income tax only applies if your activity is regular.

4. Gross Investment Income

This support element includes the gross income from interest, dividends, rents and royalties, unless the income is taxable as unrelated business income. (See Chapter 9 to figure out what is included in this exception.) Examples of these four sources are as follows:

- Interest on savings accounts or investments or interest you charge on loans to individuals or groups;

- Dividends on stock, shares (savings) in credit unions, etc. (In connection with the interest and dividends, you will get a statement from the bank or the credit union at the end of the year showing the total amount credited to your account throughout the year as dividends or interest);

- Royalties (for example, payments to you from sales of a book your group has written);

- Rents from real property and from personal property, leased with real property, to the extent that the rents are not taxable as unrelated business income.

If income from any of these sources comes from activities which further your exempt purpose in any important way, that income would be*gross receipts from related activities* (#2 above) and *not* gross investment income. For instance, if the purpose of the group is to provide facilities or make loans to sick or poor people, rent or interest from such individuals would be gross receipts from related activities.

5. Certain Tax Revenues

Tax Revenues levied by a government unit for the benefit of an organization and either paid to or expended on behalf of the organization must be counted in the total support base.

6. Certain Services and Facilities Furnished by the Government

You must count in your support base the value of services or facilities furnished by a government unit to your organization without charge, unless these services or facilities are furnished also to the general public without charge.

SUMMARY OF THE FORMULAS

PSO

NUMERATOR = Qualified Support

DENOMINATOR = Contributions, grants (excluding unusual grants), membership fees, *plus*
Net income from unrelated business activities, *plus*
Gross investment income, *plus*
Tax revenues from government, *plus*
Value of free services/facilities from government

~~**FASO**~~

~~NUMERATOR = Qualified Support~~

~~DENOMINATOR = Contributions, grants (excluding unusual grants), membership fees, *plus*~~
~~Gross receipts from related business activities, *plus*~~
~~Net income from unrelated business activities, *plus*~~
~~Gross investment income, *plus*~~
~~Tax revenues from government, *plus*~~
~~Value of free services/facilities from government~~

The total support received from these sources – all six for FASOs and five (excluding “gross receipts from related business activities”) for PSOs – represents the total support base of your group. (Use the worksheet at the end of this chapter to help you calculate your denominator.) This is the denominator for the percentage calculation explained next. The remainder of this chapter describes the different support tests for PSOs and FASOs and explains the "qualified" sources of support which make up the numerator for your calculations.

HOW TO CALCULATE YOUR SUPPORT FROM QUALIFIED SOURCES FOR THE PSO TEST

A Publicly Supported Organization is an organization which:

- normally
- receives a substantial part of its support
- from a governmental unity, or
- from direct or indirect contributions from the general public.

Two very specific tests are used to determine whether a PSO is "publicly supported" (as defined by the IRS). One is called the "mechanical test"; the other is the "facts and circumstances" test. If you pass the first, you don't need the second. If you fail the first, you still might pass the second.

Both tests involve a fraction or percentage calculation:

> First you determine your overall support. This is the denominator. (We've already covered this.)
>
> Second, you determine how much of that total support came from certain qualified specific sources. (We cover this next.)
>
> Finally, you see what percentage of your total support (denominator) came from qualified sources (numerator).

If support from qualified sources equals 33⅓ % of your total support, you have passed the "mechanical test" and are therefore a Publicly Supported Organization.

If not, you and the IRS apply the alternative "facts and circumstances" test: if your percentage of qualified support is at least 10% of total support, and you attract public support, and considering all the facts and circumstances you have the nature of a "publicly supported" organization, you have passed this test.

The Mechanical Test (or One -Third Support Test)

An organization qualifies as a Publicly Supported Organization if it *normally* receives at least $33\frac{1}{3}$% of its total support (the denominator) from *qualified sources*.

The meaning of *normally* under this test is discussed on pages 167-168.

Qualified sources of support (numerator) are governmental unit support, direct public support, and indirect public support. These are defined and calculated as follows:

Governmental Unit Support

Governmental unit support includes all donations and contributions from governmental units. It also includes grants from governmental units if the grant is made to an organization to provide a service or facility for the direct benefit of the general public. If the grant is to serve the direct and immediate need of the payor, it cannot be included.

Direct Public Support

Contributions, grants and membership fees from individuals, corporations, or trusts, are included. However, there is a limit on how much from each source can be counted. If you have some donations which are large, in comparison with other donations, read this section carefully.

Per Person Two Percent Limitation

There is a two percent per person limitation on how much direct public support you can include in your numerator. Each contribution, grant or fee amount will be fully included in the numerator only if it is not larger than 2% of the total support base (the denominator). If it is larger than that, then only the amount which represents 2% of total support is counted. This "2% limitation" is a sub-test to which each individual donor is subject. Since these calculations are over the whole normalcy period (usually 4 years, see pages 167-168), you have to know what each donor has given for each year in that period.

> *Example*: Carol donates $120 a year to the local Senior Center, an exempt organization, for the four-year "normalcy" period. During this normalcy period, the Senior Center's total support base was $10,000. Two percent of $10,000 is $200, so $200 is the support limitation per individual donor. Carol has given a total of $480 over the four year period ($120 a year for 4 years). Only $200 of

that $480 can be counted in the numerator for the mechanical test. However, it will all be counted in the denominator.

Disqualified Person Two Percent Limitation

There is a special "lumping" rule where the donor is part of certain disqualified person groups. The five types of disqualified person/groups are:

- Substantial contributors
- Foundation managers.
- 20% owner/entity substantial contributors
- Family members
- 35% disqualified persons/entity owners

For individuals who are not disqualified person, the two percent limitation rule applies only to that individual. Where the donor is a disqualified person, the two percent limitations rule for disqualified persons states that all contributions will be lumped together and treated as one contribution if they are made by a donor and by any entity that is related to that donor in the form of a 20% owner/entity substantial contributor, a family member, or 35% disqualified person/entity owner. The purpose of this lumping rule is to prevent a donor from getting around the 2% rule by giving part of her/his contribution in the donor's name and part through a family member or an organization controlled by the donor.

The starting point for determining if you have contributors who are disqualified persons is to see if you have substantial contributors who contribute to your organization. If so, you then need to examine their business and family relationships to see if you have other disqualified persons as contributors. You also need to examine whether your foundation managers or their families or businesses contributed to your group.

Substantial Contributor

A substantial contributor is any person, trust, corporation, estate, partnership, or association who gives an aggregate amount of more than $5,000 to your group, if that aggregate amount is more than 2% of the total contributions and bequests (gifts made by a will) received throughout your existence up to the close of the taxable year in which the contribution is received. Although the calculation is made based on total contributions at the end of your tax year, a person who is a substantial contributor at that time actually became a substantial contributor on the date that he or she made the contribution that pushed that donor into the substantial contributor category.

Note that the denominator for this 2% calculation is not your total support for four years but is the total of your contributions and bequests throughout your existence up to the close of the taxable year when you got the contribution. Once a person becomes a substantial contributor, she or he is always a substantial contributor, even though later on as the organization receives more support, her or his contribution may become less than 2% of the total contributions. It is these twists in the test that separate substantial contributors from other contributors subject to the Two Percent Limitation discussed on page 154.

> *Example*: On July 19, 2000, Claire gave $2,500 to the Rural Assistance Project. On May 17, 2005, she gave an additional $3,000. From its beginning until the close of 2005 (the taxable year that it received Carol's gift), the Rural Assistance Project received $200,000 in contributions from all sources. 2% of $200,000 = $4,000. Since $5,000 is more than $4,000, $5,000 is the floor that marks substantial contributions and Claire exceeded that limit. Claire is a substantial contributor as of May 17, 2005, as it is on that date that her aggregate contributions of $5,500 met the $5,000 test. Claire will always be a substantial contributor even though the organization receives donations after 2005 that reduce her contribution to less than 2% of its total contributions.

> *Example*: Suppose that Claire contributed as described above but that the Rural Assistance Project received a donation from an unrelated source of $100,000 in November of 2005. At the close of its tax year in 2005, the Rural Assistance Project's contributions now totalled $300,000. 2% of $300,000 = $6,000. Claire with her donations of $5,500 is not a substantial contributor because her donations did not meet the test *as of the end of the year that she donated*.

The consequence of becoming a substantial contributor is that this donor is now a disqualified person. This means that your organization must aggregate the donor's contributions with her or his family and business connections in applying the two percent limitation rules.

Once a person becomes a substantial contributor, she or he is always a substantial contributor, even though later on as the organization receives more support, her or his contribution may become less than 2% of the total contributions.

The government and other PSOs are not substantial contributors, unless their contributions to your group were given to them by a donor who earmarked them to be given to you.

Foundation Manager

This category includes:

- officers and directors of a foundation, or individuals having similar powers or responsibilities; or
- with respect to any act, or failure to act, the employees of the foundation having authority or responsibility with respect to such act or failure to act.

A person will be considered an *officer* if:

- she or he is so designated in the Articles or Bylaws;
- she or he regularly exercises general authority to make administrative or policy decisions on behalf of the organization.

> *Example*: If your group received a contribution from a foundation manager and a contribution from the family members of a foundation manager or a contribution from a foundation manager and from an entity of which the foundation manager owns 35%, these contributions must be combined for purposes of the 2% rules.

There is some ambiguity between the statute and the IRS interpretation on the issue of whether the director or officers of a public charity are "foundation managers." The statute and regulations appear to define this category with reference to private foundations. The IRS seems to interpret foundation managers to include managers of public charities. If the definition makes a difference to your group, you may want to see a lawyer.

Twenty percent Owner/Entity Substantial Contributor

This type of "disqualified person" is an owner of more than 20% of:

- the total combined voting power of a corporation which is a substantial contributor;
- the profits interest of a partnership which is a substantial contributor; or
- the beneficial interest of a trust or unincorporated association which is a substantial contributor.

In other words, if one of these entities is a substantial contributor, its owners of more than 20% of the voting power, profits, or beneficial interest also become substantial contributors. Thus, organizations need to inquire into the ownership of entities which are substantial contributors.

Family Members

Your organization must lump contributions from family members of substantial contributors, foundation managers, and 20% owner/entity substantial contributors with the contributions of those substantial contributors and foundation managers. Family members include the spouse, direct ancestors, lineal descendants, or spouses of a lineal descendant. A brother or sister is not a family member; the spouse of a grandchild is.

35% Disqualified Person/Entity Owner

When a substantial contributor, foundation manager, twenty percent owner/entity, or family member owns 35% of a corporation, partnership, trust or estate, the entity also becomes a disqualified person. This is the reverse of the 20% owner/entity substantial contributor.

There are many special rules in addition to the definitions given here. If you need further information, see an attorney or accountant.

Comprehensive Example of the Mechanical Test:

Raoul is a substantial contributor to the Community Resource Fund because of large donations made in previous years. During the 4-year normalcy period, his donations total $50,000. Raoul owns 60% of Solarheat Company, which also has donated a total of $50,000 to the Resource Fund. The Fund's total support base for the normalcy period is $3,000,000, 2% of which would be $60,000.

Raoul contributed	$50,000
Solarheat contributed	$50,000
TOTAL	$100,000
2% limitation	$60,000
Excess over 2% not counted	$40,000

Thus $40,000 will be excluded from the numerator for purposes of the mechanical test. If the disqualified person relationship had not existed between Raoul and Solarheat Company, each contributor could have been fully counted in the numerator.

Amounts excluded from the Two Percent Limitation

The 2% limitation applies only to direct public support, and not to unusual grants (described below), support from governmental units (see page 154), or indirect public support (see below).

Unusual Grants Excluded from the Two Percent Limitation Rules

Many small groups dream of someday receiving the huge contribution that will end their financial problems. Such a grant could, instead, cause them to lose their public charity status and be classified as a private foundation. Why? Recall that the whole contribution would be counted in the support base (denominator) but in many cases only a small part of it could be included as qualified support (numerator) because of the 2% per person limitation. So, such a gift could throw off a group's financial support percentage so that it failed both the mechanical and the fact and circumstances support tests. This phenomenon is referred to as "tipping." Some private foundations consider this problem when evaluating large grant requests from small organizations.

In some cases, such a grant qualifies for an "unusual grant exclusion" and can be excluded from both the numerator and denominator, thus avoiding the 2% limitation and the distortion of the support test percentages.

To qualify, the grant must come from a disinterested person and:

- Was attracted because of the publicly supported nature of the organization;
- Is unusual or unexpected because of its size or because it is not regularly received (e.g., a bequest in a will);
- Would, because of its size, adversely affect the status of the organization because of its effect on the organization's support percentages.

The IRS has a longer list of facts and circumstances to consider in determining whether a grant qualifies for the exclusion. If you should be so fortunate as to encounter this mythical beast, consult an attorney or accountant immediately and before actually receiving the gift if possible.

Indirect Public Support

The third qualified source of support that goes into the numerator of the PSO calculation is indirect public support. This includes contributions received from another Publicly Supported Organization or any public charity (i.e., non-private foundation) that could also qualify as a Publicly Supported Organization. For example, a group classified by the IRS as a church might also meet the IRS criteria for a Publicly Supported Organization. If it did, its contributions to your group would be considered indirect public support and would not be subject to the 2% limitation. Other nongovernmental contributions are direct public support and subject to the 2% limitation rules.

However, if a donor makes a contribution to a government unit or PSO (or a public charity that could qualify as a PSO) and earmarks it for your organization, the pass-through gift will be counted as *direct* public support from the original donor and will be subject to the 2% limitation.

Example: The Women's Alliance for Peace is an exempt organization. For the four years 2000 through 2004 (the applicable normalcy period for tax year 2005), it received support as follows:

State of Oregon (a governmental unit)	$20,000
United Fund (a PSO – indirect pub. support)	$45,000
Contributions (direct public support)	$25,000
Women's Cultural Center (a FASO) (direct public support)	$15,000
TOTAL	**$105,000**

33$^{1}/_{3}$% of total = $35,000

To apply the mechanical test, WAP calculates which of those sources listed in total support are qualified sources, and whether they amount to 33$^{1}/_{3}$% of total support, keeping in mind the 2% per person limitation on direct public support.

State of Oregon (no limit)	$20,000
United Fund (no limit)	$45,000
Contributions (no individual gave more than $2100 which is 2% of total support)	$ 4,500
Contributions (5 contributions exceeded $2100, so 5 X $2,100=maximum countable)	$10,500
Women's Cultural Center (max. $2,100)	$ 2,100
TOTAL	**$82,100**

Note that only $2,100 of the Women's Cultural Center's $15,000 contribution was included in the numerator because the Women's Cultural Center is a FASO. If the Women's Cultural Center could also qualify as a PSO, the entire amount of its $15,000 would be counted. The Women's Alliance for Peace has normally received more than $33^1/_3$% of its support from governmental units and the general public. Therefore, it passes the mechanical test.

PSO:

NUMERATOR = Governmental unit support, plus
Direct public support, plus
– below 2% limitation, and
– subject to 2% limitation
Indirect public support

DENOMINATOR = Same as PSO on page 152

Use the worksheet at the end of this chapter to calculate your numerator as a PSO.

Facts and Circumstances Test

If an organization's qualified support does not equal $33^1/_3$% of its total support, it fails the mechanical test. But if its qualified support equals at least 10% of its total support and it is organized and operated in such a way as to attract public support, then it can turn to the "facts and circumstances" test. "Organized and operated to attract public support" means the organization has a continuous and genuine program for soliciting funds from qualified sources (discussed above), such as governmental units, and direct and indirect public support.

If your organization meets these minimum requirements, the following factors will be considered to determine if your groups has the nature of a publicly supported organization:

- financial support percentages
- support sources
- representative government body
- public facilities, services, programs, policies and participation
- membership relations

Financial Support Percentage

The closer to $33^1/_3$% the organization's qualified support is, the less public support it has to demonstrate with the other factors. Of course, the closer it falls to the 10% bottom line, the greater burden it will have with regard to the other factors.

Support Sources

Favorable consideration is given to your organization when your existing sources of support come from a number of individuals that are representative of the community you seek to reach, rather than from the members of a single family. Factors to be considered in determining whether the number is representative are:

- the type of organization
- length of time it has existed (has it had time to gather wide support?)
- whether it limits its activities to a particular community or region (so then it only has to show wide support within that region)
- whether it limits its activities to a special field which can be expected to appeal to a limited number of persons (then it only has to show wide support from people within that field).

Representative Governing Body

Here the IRS is looking for a governing body (generally the Board of Directors) which represents the interests of the public, not the personal or private interests of a limited number of donors or officers. They will be satisfied with a Board made up of:

- public officials
- persons selected by public officials
- experts in the field in which the organization is operated
- community leaders representing a broad cross-section of the community
- persons selected by a broadly-based membership according to procedures established in articles or Bylaws

Public Facilities, Services, Programs, Policies and Participation

Favorable factors include:

- providing a service or facility for the general public; for example, museums or libraries;
- regular publication of studies that are widely used by colleges or the public;

- participation in or sponsorship of programs by civic or community leaders or experts in the field;
- maintaining a well-defined ongoing program to accomplish charitable work in the community;
- receiving a significant part of the organization's funds from a public charity or governmental unit to which the organization is held accountable as a condition of the grant or contract.

Membership Relations

The IRS looks for:

- whether solicitation for members is designed to enroll a large number of people in the community or area of special interest;
- whether the individual membership charge is affordable by many persons and not what only a few could afford;
- whether the activities of the organization will be likely to appeal to persons having a broad common interest, such as educational activities, musical activities, etc.

An organization does not have to show favorable facts under every category. In each case, the importance of each factor will be different depending onthe nature and purpose of the organization and how long it has existed. The ultimate objective is to find out whether the organization is "publicly supported."

~~HOW TO CALCULATE YOUR SUPPORT FROM QUALIFIED SOURCES FOR THE FASO TEST~~

~~A FASO is an organization which normally receives:~~

- ~~More than $^1/_3$ of its support from any combination of contributions, grants, or membership fees, and gross receipts from related business activities; and~~
- ~~Not more than $^1/_3$ of its support from the sum of gross investment income; and the amount of the unrelated business taxable income less the amount of the unrelated business income tax.~~

~~The meaning of normally is the same as that discussed on pages 167-168.~~

~~You must use the cash method of accounting (see Chapter 23) for purposes of calculating your support.~~

THE NORMALCY PERIOD

General Rule

The mechanical test and the facts and circumstances tests for PSOs and the support test/investment income test for FASOs all are defined in terms of what normally occurs. Normally is usually the four years preceding the tax year in question. The long time period is used to get a more accurate picture of an organization's usual sources of support. Once an organization meets the test for a given tax year, the test is satisfied for that year and the next year.

As an example, the Women's Alliance for Peace (see page 160) has satisfied the test for the years 2005 and 2006. This allows donors to make contributions throughout the year and count on taking their deductions; otherwise, they'd have to wait until the end of the year to see whether the organization they were donating to still qualified. Chaos at the IRS!

If your organization has been in existence for at least one taxable year of more than eight months but less than five taxable years, the number of years you have been in existence immediately preceding the current taxable year will be substituted for the four- year period described above and will be your normalcy period. If you have not been in existence for at least one taxable year of eight months, you are not yet eligible for a definitive ruling and so the normalcy period rules have no meaning for you. See page 109 for how to proceed.

In figuring out how many years you have been in existence, start with the date you were formed if you are an unincorporated association and the date you were incorporated if you are a corporation. If you operated as an unincorporated association for a period of time (and did not file for tax-exempt status) and are now a corporation, you can only use the years since incorporation toward the normalcy period.

Exception: Substantial Changes in Sources of Support

If there is a substantial and material change in an organization's sources of support (for instance, an unusually large contribution which doesn't qualify for the unusual grant exclusion), the normalcy period becomes five years: the usual four-year period preceding the year of substantial and material change plus the taxable year of substantial and material change.

If despite using this five- year normalcy period, the organization fails to meet the test percentages, contributors still get their tax deductions until the IRS makes public the organization's change in status. This protection may not apply to the donor who caused or was aware of the material and substantial change. If you encounter this problem, consult an attorney or accountant before you receive the gift, if possible.

RECORDKEEPING ISSUES

It should be clear from reading the complex set of rules above that detailed recordkeeping about contributions is critical. Your organization needs to know not only who has contributed how much over the life of the organization, but also a considerable amount of detailed information about the contributing individuals and organizations and their family and business connections.

Detailed recordkeeping about contributions is critical.

We have included as appendices some sample letters to be sent to grantors, organizations and individuals. The purpose of the letter to granting organizations (Appendix 10) is identification of their tax status. This will be essential for your determination of whether the grant from this grantor should be classified as direct or indirect support, etc. The second sample letter (Appendix 11) is intended for individuals who you think may be disqualified persons. Remember that these disqualified persons may include foundation managers and individuals contributing both individually and through corporations, partnerships or other entities in which they hold significant ownership interests and their family members.

On the following pages are some worksheets you can use to calculate the numerators and denominators for the support tests for PSOs and FASOs.

Consult Appendix 1 if you would like information about source material related to this Chapter.

Now that you've sorted out your nonprofit's status as a PSO or FASO, you'll want to clear your thoughts to tackle the challenge of understanding the IRS rules regarding political activity and lobbying by tax-exempt organizations. Chapter 8 is designed to help you understand these very important restrictions and prohibitions.

PSO
WORKSHEET
NUMERATOR
FOR NORMALCY PERIOD

QUALIFIED SOURCES OF SUPPORT

Governmental unit support (page 154)	$____________
Direct Public Support:	
Contributions, grants and membership fees below the 2% limitation (page 154)	$____________
Contributions, grants, and membership fees subject to the 2% limitation (page 154) [Take the number of such items and multiply it by 2% of your denominator]	$____________
Indirect Public Support: Contributions, grants and membership fees (page 159)	$____________
Subtract unusual grants (page 159) (if included above)	$____________
TOTAL	$____________

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FOR NORMALCY PERIOD

TOTAL SUPPORT BASE

Gifts, grants, contributions, membership fees (page 149) – Exclude "unusual grants" (page 159)	$__________
Net income from unrelated business business activity (page 150)	$__________
Gross investment income (page 151)	$__________
Tax revenues levied by government for your group (page 151)	$__________
Value of free services or facilities furnished by government to your group (page 152)	$__________
TOTAL	$__________