1. **When Worlds Collide: GAAP vs. TAX**

   **Terry Miller**
   Financial Management Consultant, San Francisco
   www.managing4change.com
   TBearSFO@compuserve.com

2. **Thesis**
   - Some issues in accounting can look differently if viewed narrowly through either a GAAP or a TAX lens.
   - Managers are often advised by a practitioner well-versed in one discipline but not the other.
   - This can lead to problems.
   - Management planning can help. Managers need to know what they want and why. Practitioners need to be on guard to not see only one point of view.

3. **Issues Overview**
   - *Government Awards:* Fee or gift?
   - *Cost-sharing Arrangements:* Revenue or reimbursement?
   - *Fiscal Sponsorship:* What to do about imperfect Variance Power?
   - *Gifts in Kind of Property or Services:* Proper reporting
   - *Joint Costs and SOP 98-2:* Avoiding distortion
   - *Prepaid Fundraising Costs:* Expense or asset?
   - *FMV on Investments:* Proper reporting
4. Presentation Structure

- Slides on each Issue
  - The Issue (some long, some short, some hard, some easy)
  - GAAP View
  - TAX View
  - Planning / Solutions
- Some departures for special topic discussion
- Supplemental materials:
  - slides numbered in lower right corner; ties to numbered headings in handout outline (greater detail in outline)
  - additional materials follow outline

5. Overarching Considerations

- Nonprofits, being tax exempt, are creatures of the tax code
  - SAS 5 & 69 “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles”
- GAAP requires Professional Judgment to avoid misleading financial statements that technically conform but distort nonetheless
  - Form 990 2005 Instructions, General Instruction G
- TAX requires that generally should use same method as books:
  - “Unless instructed otherwise, the organization should generally use the same accounting method on the return to figure revenue and expenses as it regularly uses to keep its books and records.”
- Era of Transparency

6. Government Awards: Fee or Grant?

- Government Awards are often titled “Contract,” have specific deliverables, and are paid on a reimbursement basis, so practitioners (and managers) conclude that all government awards are exchange transactions – earned fees, rather than conditional gifts
- Earned income can wreak havoc with the public support test
  - some social service agencies at risk of private foundation classification under IRC 509(a)
- Government grant support is very helpful
  - vital balance to potential future major private foundation or donor support
7. Government Awards: GAAP View

- GAAP does NOT require that all government awards be treated as [reciprocal] Exchange Transactions
  
  “The Board believes that whether a grant is from a government agency, private foundation, or corporation, the difficulties in determining whether a transfer is an exchange transaction or a contribution are substantially the same.”

  “…excluding [as contributed income] all governmental transfers is neither necessary nor desirable because that would further delay improvements to practice.”

- Conditional Promises to Give may resemble Exchange Transactions, in a ‘pay for unit of delivery’ manner

8. Government Awards: TAX View

- Regs 1.170A-9(e)(8) and (9) & 1.509(a)(3)(f) and (g) [Re: 509(a)(1) & (2) tests]

- Reg 1.170A-9(e)(8)(ii) [grant support] “if the purpose of the payment is primarily to enable the organization to provide a service to, or maintain a facility for, the direct benefit of the public…rather than to serve the direct and immediate needs of the payor.”

- Examples given
  - maintenance of library facilities
  - amounts paid under Government programs to nursing homes or homes for the aged
  - amounts paid to child placement or child guidance organizations under Government programs

  “are considered payments the purpose of which is primarily to enable the recipient organization to provide a service or maintain a facility for the direct benefit of the public, rather than to serve the direct and immediate needs of the payor.”


- Management / auditor discussion, record properly (more often donative than what we see in practice)
  - Why is it earned income if a government pays to help the public but donated income if a foundation does so?
  - Downside: not so easy to make “profit” on grant as on earned income

- Split Book v. Tax: Exchange Transaction for GAAP, Donative Support for Tax
o Does this violate general rule to use same method? Argue that Tax Regs are different than GAAP, ergo split method is allowed

o Note: will not show up on Form 990 v. Audit reconciliation, (Form 990 Part IV-A) which measures total income

o Be sure to think through:
  ▪ deferred revenue vs. temporarily restricted net assets
  ▪ cost of Fee generation is Mgt & Gen, Grants generation is Fundraising

10. Cost-sharing Arrangements: The Issue

- Consider C3 charity “OldCorp” starting C4 lobby “NewCorp”
- OldCorp allows NewCorp to share resources and reimburse
- OldCorp inter entity: revenue or expense reduction?
- If revenue, OldCorp might “own” all of the activities, possibly defeating the reason for the spin-off
- If revenue, total economic activity is overstated: “the world does not add up”
- If revenue for GAAP but expense reduction for TAX: it shows up on the 990 reconciliation schedule, must explain to public

11. Cost-sharing Arrangements: GAAP View

- Disclosure (footnotes) is required & recommended
- If consolidated or combined f/s, tax return becomes “net” due to elimination entries
  o Consol required if parent/sub and economic interest
  o Combined sometimes permitted if common control
- Practitioners hesitant to combine dissimilar tax types
- If not combined, GAAP tends towards revenue.
- Analogous to shipping & handling? Revenue.
- Analogous to travel reimbursement for speech by CEO? Reimbursement.
12. Cost-sharing Arrangements: TAX View

- TAX wants Net (expense reduction not revenue)
- OldCorp C3 does not want to “own” the extra lobbying activities engaged in by the NewCorp C4; entire reason for starting affiliate.
- “Other revenue” is also a drag on the public support test.


13. Cost-sharing Arrangements: Planning / Solutions

- Management / auditor discussion, use one of two analogies:
  1) either: joint dominion & control over a resource, reimbursement for efficiency,
  2) or: simple reimbursement such as a travel bill paid by a separate entity
- Full disclosure, in financial statement footnotes and Form 990, explaining dollar transactions between entities:
  o total amount,
  o component parts in relevant summary,
  o method of calculation
- Treat all reimbursements as expense reductions, using contra-sub-expense lines if necessary, to facilitate disclosure

14. Fiscal sponsorship: The Issue

- Sometimes (here, in particular) “Fiscal sponsorship” means grantor payment to intermediary “sponsor” public charity, which in turn grants to end recipient that is not a public charity
  o NPOs often misunderstand the delicacy of this transaction and refer to it as a “pass-through”
- If the sponsor does not have full “discretion and control” in TAX language, or “variance power” in GAAP, then it is a pass-through transaction
  o If so, the sponsor is merely acting as the agent for the originating donor or the agent for the final recipient, so there is only one substantive gift, not two
  o If so, the originating donor loses the deduction or makes a taxable expenditure.
15. Fiscal sponsorship: 5 Elements in an Ideal World

- The elements of the re-granting sponsor’s position that should be in place:
  1. Bylaws clauses: default for all gifts is discretion; “pass-through” require Board approval, and
  2. Decision by the sponsor’s Board affirming each sponsorship as advancing sponsor’s purposes, and
  3. The transaction is income and expense, not just liability and payment, and
  4. Written proposal from the project to the sponsor seeking sponsorship, in advance, and
  5. Explicit written notice to or from the grantor that the sponsor retains discretion and control over, or explicit “unilateral power to redirect” the funds.

16. Fiscal sponsorship: GAAP View

- If the end recipient is named, GAAP is particularly insistent on explicit notice to or from the grantor that the sponsor retains “unilateral power to redirect” funds

- There is some slight wiggle room if the request is made somewhat broadly:
  “If that request is conveyed in a manner that leads a donor to reasonably conclude that its role is merely to propose a possible allocation, the recipient organization has the discretion to choose the beneficiary of the assets.” (¶ 70)

- It helps if the Governing Documents of the sponsor make it clear that the sponsor always retains variance power. Some GAAP practitioners have settled on an interpretation of the donor’s understanding of the sponsor’s unilateral control as being that the donor ‘knew or should have known,’ for example in the context of Donor Advised Fund agreements with community foundations that may not have been perfectly drafted in the past.
17. Fiscal sponsorship: TAX View

✓ Fiscal Sponsorship: 6 Ways to Do It Right, Greg Colvin, San Francisco Study Center Press, 2005 (2d edition). (Footnote on Page 3 contains references to judicial decisions, Rev Ruls and a PLR).


✓ See discussion of Tax Regs & trust-form community foundations at FAS136 ¶ 84

• TAX considers the overall facts and circumstances, not just donor granting of variance power, but discourages agency and conduit arrangements:

• “The Service's longstanding position is that an EO receives a charitable contribution where it has full control and discretion as to the use of donated funds, but not where the donor earmarks the contribution for use by an individual or nonexempt organization (or makes the contribution pursuant to a commitment or understanding that the funds will be so used).” (CPE Article)

18. Variance Power: 2 Other Considerations

• Federated Fundraising Campaigns
  o Problem: need to show Fundraising % of Total raised, even if no variance power
    ▪ See display suggestions FAS 136, ¶ 109

• Sometimes pass-through is desirable and should be planned accordingly
  o Sub-grantees are known, are public charities, and sponsor may have a tipping problem due to size of gift

19. Fiscal sponsorship: Planning / Solutions

• Managers: Plan ahead, do it right

• Practitioners: keep in mind the overall situation, carefully interpret and factor in client intentions;
  o consider passing on a mildly flawed setup one year and
  o use the management letter to induce the client to put the necessary elements in place
20. Gifts of Property or Services: The Issue
   - With regard to non-cash gifts, donated use of facilities, and donated services:
   - GAAP statements are frequently inadequate
     - Transactions not recognized
     - Disclosures not made

21. Gifts of Property or Services: GAAP View
   - Record gifts of property at fair market value
   - Record gifts of use of facilities if would need to be paid for otherwise
   - Recognize contributions of services if:
     - “Create or enhance nonfinancial assets or
     - Require specialized skills…and would typically need to be purchased if
       not provided by donation”
   - Disclose in footnotes extent of donated services even if not at level that leads to recognition

22. Gifts of Property or Services: TAX View
   - Record gifts of property at fair market value
   - Do NOT record use of facilities (in most cases) or gifts of donated services
   - Form 990 explicitly provides spot for reconciliation to audited GAAP statements
     - Form 990, Part IV-A, Line b2, and Part IV-B, Line b1
23. Gifts of Property or Services: Planning / Solutions:

<table>
<thead>
<tr>
<th>3x3 Table:</th>
<th>TAX</th>
<th>GAAP</th>
<th>Bragging Rights (Annual Reports, Funder Proposals, web)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Donated property:</strong> stock, laser printer, substantial amount of office supplies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Certain donated services:</strong> professional services pro-bono or discounted, services you would have had to pay for, some facilities such as meeting rooms, lodging for guest speakers</td>
<td>NO</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Volunteer time, Board, grassroots volunteers</strong></td>
<td>NO</td>
<td>NO</td>
<td>Yes</td>
</tr>
</tbody>
</table>

24. Joint Costs and SOP 98-2: The Issue

- Costs of certain kinds of mixed purpose (program+fundraising) activities that include a fundraising “ask” get counted as 100% fundraising under SOP 98-2, causing distortion: overstatement of fundraising costs
- This distortion weakens donor confidence and harms the reporting organization

25. Joint Costs and SOP 98-2: GAAP View

- Subject to multiple tests and criteria:
  - audience,
  - content,
  - compensation,
  - purpose
  any of which can lead to 100% fundraising


- Form 990 asks if SOP 98-2 is used
- Practitioners disagree about whether this:
  - means reporting entity may depart by not checking 98-2 box on joint costs
  - or is simply asking “are your books [and 990] on a GAAP basis
GAAP is legally required by charities fundraising in California, for example.

27. Joint Costs and SOP 98-2: Planning / Solutions
- Use professional judgment to override SOP 98-2, or
- If SOP 98-2 causes distortion, discuss in audit footnotes and split TAX & GAAP reporting of functional totals, or
- Do a qualified audit, and for transparency, prepare a footnote showing functional totals under both methods even though 98-2 is not being used.

28. Prepaid Fundraising Costs: The Issue
- TAX, unlike GAAP, allows prepaid fundraising costs to be expensed over the life of the effect of the effort
- 990 constantly scrutinized for functional totals; big fundraising drive to build a list, for example, can make one particular year look bad to the public
- What to do?

29. Prepaid Fundraising Costs: GAAP View
- Requires expensing of all promotional costs

30. Prepaid Fundraising Costs: TAX View
- Form 990 contemplates, even invites, use of “prepaid fundraising costs”
  - Can be used to avoid overstating fundraising cost in one year as proportion of total costs; might be useful if a big campaign would drive supporting functions over a level which is publicly palatable or qualifies for participation in federated fundraising

31. Prepaid Fundraising Costs: Planning / Solutions
- If using this TAX option,
  - prepare to explain variance on GAAP v. TAX reconciliation schedule with a good attached explanation, because it will change total expense between the two; explanation may sound like “fast” accounting to public, watchdogs
- Alternately, follow GAAP, and
o consider expensing all in one year and attaching explanation of why supporting costs are unusually high this one year

32. FMV on investments: The Issue

- TAX forms are often done incorrectly
- GAAP requires investments be recognized at Fair Market Value (FMV), but TAX makes it optional
- Confusion reigns on reporting unrealized gains and losses for TAX

33. FMV on investments: GAAP View

✓ A&A Guide, Chapter 8
✓ FAS 124

- Show most investments at Fair Market Value

34. FMV on investments: TAX View

✓ Form 990 2005 Instructions, Page 20, Column 3; Page 22, Column 2
✓ Form 990, Line 20 OR Form 990, Part IV-A/IV-B

- If using FMV, show unrealized gains and losses on Line 20
- If not using FMV, show variance in income/expense on GAAP reconciliation, Part IV

36. FMV on investments: Planning / Solutions

- Increased rigor and consistency by tax preparers & reporting entities: get it right!
ADDITIONAL MATERIALS

Dick Larkin’s outline of Form 990 Instruction departures from GAAP

Commentary on Professional Judgment

FAS Paragraphs & Tax Regs on Government Awards: Gift or Fee?
## Differences between GAAP and IRS rules

**Richard Larkin, BDO Seidman, LLP, presented to June 2003 AICPA Not for Profit Conference**

<table>
<thead>
<tr>
<th>Subject</th>
<th>GAAP</th>
<th>Tax</th>
<th>GAAP</th>
<th>Citations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accounting</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Donated services of volunteers:</td>
<td>must be recorded if specified criteria are met</td>
<td>may not be reported in Part I of Form 990 (optional to disclose on line 82)</td>
<td>SFAS 116, para. 9</td>
<td>(I) - page 17 (for line 1) - bottom of right column, and page 28 (line 82)</td>
</tr>
<tr>
<td>Consolidated statements for affiliated entities:</td>
<td>must be prepared if certain criteria are met</td>
<td>may not be filed, except under a group exemption</td>
<td>SOP 94-3</td>
<td>(I) - page 13 - (GI - R)</td>
</tr>
<tr>
<td>Effects of accounting changes:</td>
<td>are sometimes reflected retroactively by restating prior years’ data</td>
<td>must be shown as a current year item</td>
<td>APB 20, and various new standards</td>
<td>(I) - page 5 - (GI - G) - right column</td>
</tr>
<tr>
<td>Accrual basis:</td>
<td>required</td>
<td>not required except for UBI activities (Note 1)</td>
<td>(SAS 69, para. 5, 10; SAS 62, para. 4c)</td>
<td>(I) - page 5 - (GI - G) - right column</td>
</tr>
<tr>
<td>Prepaid fundraising costs</td>
<td>must be expensed in the period incurred</td>
<td>may be reported as assets</td>
<td>Audit Guide, para. 13.06</td>
<td>(I) - line 53</td>
</tr>
<tr>
<td>Investments:</td>
<td>most investments must be reported at fair value</td>
<td>may be reported at either cost or fair value</td>
<td>SFAS 124, para. 7</td>
<td>(F) - line 54</td>
</tr>
<tr>
<td>Grants made to others</td>
<td>SFAS 116 is required</td>
<td>not required</td>
<td>SFAS 116, para. 18</td>
<td>(I) - line 22 (6th para.)</td>
</tr>
<tr>
<td><strong>Reporting format</strong> **</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets:</td>
<td>3 classes required</td>
<td>not required</td>
<td>SFAS 117, para. 13</td>
<td>(F) - lines 67-69 vs. 70-72</td>
</tr>
<tr>
<td>Change in net assets:</td>
<td>total must be shown</td>
<td>total is not shown</td>
<td>SFAS 117, para. 18</td>
<td>(F) - lines 18 &amp; 20</td>
</tr>
<tr>
<td></td>
<td>must be shown by class</td>
<td>not shown by class</td>
<td>SFAS 117, para. 19</td>
<td>(F) - line 18</td>
</tr>
<tr>
<td><strong>Revenue from special fundraising events:</strong></td>
<td>all event revenue may be reported together in one caption</td>
<td>contribution portion is shown separately from purchase portion</td>
<td>Audit Guide, para. 13.24-.25</td>
<td>(I) - page 18 (for line 1a) - middle of middle column, and p. 20 (line 9)</td>
</tr>
<tr>
<td>-------------------------------------------</td>
<td>-------------------------------------------------</td>
<td>-------------------------------------------------</td>
<td>-------------------------------</td>
<td>------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Functional expenses:</strong></td>
<td>required for all organizations</td>
<td>required only for 501(c)(3) and (4) organizations</td>
<td>SFAS 117, para. 26</td>
<td>(I) - lines 13-15, and part II</td>
</tr>
<tr>
<td></td>
<td>must be shown separately for major classes of program services</td>
<td>are shown in total for all programs together</td>
<td>SFAS 117, para. 26</td>
<td>(F) - line 13, and part II</td>
</tr>
<tr>
<td><strong>Statement of functional expenses:</strong></td>
<td>required only for voluntary health &amp; welfare organizations (VHWOs)</td>
<td>required for all 501(c)(3) and (4) organizations</td>
<td>SFAS 117, para. 26</td>
<td>(F) - part II, col. B,C,D</td>
</tr>
<tr>
<td><strong>Natural expense categories:</strong></td>
<td>required only for VHWOs</td>
<td>required for all organizations</td>
<td>SFAS 117, para. 26</td>
<td>(F) - part II, col. A</td>
</tr>
<tr>
<td><strong>Specific categories of financial statement elements:</strong></td>
<td>generally not specified</td>
<td>specific categories required</td>
<td>SFAS 117 gives example categories only</td>
<td>(F) - parts I, II, IV</td>
</tr>
<tr>
<td><strong>Statement of cash flows; Footnotes:</strong></td>
<td>required</td>
<td>not required</td>
<td>SFAS 117, para. 6</td>
<td>(I) - page 4 - (GI - E) - lower right column (under &quot;Additional information...&quot;)</td>
</tr>
<tr>
<td><strong>Additional information:</strong></td>
<td>not required</td>
<td>various other schedules and questions are required</td>
<td>SFAS 117, para. 6</td>
<td>(F) - heading; schedules supporting certain lines; parts III, IV-A, IV-B, V - X; Sch. A</td>
</tr>
<tr>
<td><strong>Related party transactions:</strong></td>
<td>disclosure of material items required (some exceptions)</td>
<td>required only for transactions between a 501(c)(3) and non-(c)(3)s</td>
<td>SFAS 57, para. 2</td>
<td>(I) - page 10 - (GI - O); Schedule A - part VII</td>
</tr>
<tr>
<td><strong>Number of fiscal years presented</strong></td>
<td>not specified (normally nonprofits present the same number of years for all statements)</td>
<td>2 years' balance sheets; one year's revenues and expenses</td>
<td>--</td>
<td>(F) - parts I, II, IV</td>
</tr>
</tbody>
</table>

**Other**

**Financial statements:**

**Form 990:**

**Public disclosure:**

not required | required, on request | -- | (I) - page 8 - (GI - M) |
**Deadline for issuance; penalties:**

| none specified by law (for non-SEC registrants) | Specified by IRS | -- | (I) - page 6 - (GI - H & K) |

**If fiscal year is changed:**

| may be prepared for either the "short" or the "long" period | must be prepared for the "short" period | -- | (I) - page 5 - (GI - G) - top of right column |

**Audit:**

| (although not a matter of GAAP, an audit is required only by some states, funders, and watchdog agencies) | not required | various state rules; OMB Circular A-133; other requirements | (I) - page 4 - (GI - E) - lower right column (under "Additional information ...") |

**Applicability:**

| no distinction by size or type of organization (except reporting of expenses by VHWOs, as noted above; also, some states exempt small organizations from filing) | very small organizations, churches, and some others not required to file; small organizations may file a simplified form (990-EZ) | SFAS 117, para. 1, merely refers to "a not-for-profit organization." | (I) - page 2 - (GI - B); (GI - A - as to Form 990-EZ) |

**Signature of an organization officer**

| not required | Required | -- (Note 2) | (I) - page 14 - (GI - W) |

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**Note 1:** The IRS instruction is to, "generally use the same accounting method ... as it regularly uses to keep its books and records." This language does not mandate use of financial reporting methods. It merely requires that the taxpayer maintain reconciling entries as part of its permanent books and records. Some states require that copies of Form 990 filed with them be prepared on the accrual basis. Also, Part IV-A of Schedule A must be prepared on the cash basis. If there is a desire to change the Federal tax accounting method for an item or the overall method of accounting, the tax exempt entity must file Form 3115 to request permission of IRS to change. These changes are made under Rev. Proc. 97-27 (nonautomatic) or Rev. Proc. 2002-9 (automatic).

**Note 2:** However, some states and others may require nonprofit organizations to comply with the Sarbanes-Oxley Act, which does require signatures of organization officers.
Re: Professional Judgment

[Excerpts]
The Commission on Auditors Responsibilities:
Report, Conclusions, And Recommendations,
An Independent Commission Established by the AICPA (1970’s)

http://www.biz.colostate.edu/qfr/references/CommissiononAuditorsResponsibilities.pdf

Accounting and auditing pronouncements state or imply the need
for informed judgment “as to the relative appropriateness of acceptable
alternative principles and methods of application in specific circumstances
of diverse and complex economic activities.”

The auditor is responsible for determining whether management's
judgments were appropriate. This requires much more than the mechanical
application of specific rules. For example, if a transaction appears to have
been structured to meet the literal but not the substantive requirements of
accounting pronouncements, the auditor should object and insist on
revision of the financial statements or qualify his opinion.

Judgment pervades accounting and auditing. It is exercised in
considering whether the substance of transactions differs from their form,
in resolving questions of materiality and adequacy of disclosure, in
deciding whether an estimate can be made of the effects of future events
on current financial statements, and in allocating receipts and expenditures
over time and among activities.”

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STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

3. This Statement applies to contributions of cash and other assets, including promises to give. It does not apply to transfers of assets that are in substance purchases of goods or services—exchange transactions in which each party receives and sacrifices commensurate value. However, if an entity voluntarily transfers assets to another or performs services for another in exchange for assets of substantially lower value and no unstated rights or privileges are involved, the contribution inherent in that transaction is within the scope of this Statement.

4. This Statement does not apply to transfers of assets in which the reporting entity acts as an agent, trustee, or intermediary, rather than as a donor or donee. It also does not apply to tax exemptions, tax incentives, or tax abatements, or to transfers of assets from governmental units to business enterprises.

Definitions

5. A contribution is an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Other assets include securities, land, buildings, use of facilities or utilities, materials and supplies, intangible assets, services, and unconditional promises to give those items in the future.

6. A promise to give is a written or oral agreement to contribute cash or other assets to another entity; however, to be recognized in financial statements there must be sufficient evidence in the form of verifiable documentation that a promise was made and received. A communication that does not indicate clearly whether it is a promise is considered an unconditional promise to give if it indicates an unconditional intention to give that is legally enforceable.

7. A donor-imposed condition on a transfer of assets or a promise to give specifies a future and uncertain event whose occurrence or failure to occur gives the promisee a right of return of the assets transferred or releases the promisor from its obligation to transfer assets promised. In contrast, a donor-imposed restriction limits the use of contributed assets; it specifies a use that is more specific than broad limits resulting from the nature of the organization, the environment in which it operates, and the purposes specified in its articles of incorporation or bylaws or comparable documents for an unincorporated association.

Contributions Received

8. Except as provided in paragraphs 9 and 11, contributions received shall be recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Contributions received shall be measured at their fair values. Contributions received by not-for-profit organizations shall be reported as restricted support or unrestricted support as provided in paragraphs 14-16.

Contributed Services

9. Contributions of services shall be recognized if the services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Services requiring specialized skills are provided by accountants, architects, carpenters, doctors, electricians, lawyers, nurses, plumbers, teachers, and other professionals and craftsmen. Contributed services and promises to give services that do not meet the above criteria shall not be recognized.

10. An entity that receives contributed services shall describe the programs or activities for which those services were used, including the nature and extent of contributed services received for the period and the amount recognized as revenues for the period. Entities are encouraged to disclose the fair value of contributed services received but not recognized as revenues if that is practicable.

Contributed Collection Items

11. An entity need not recognize contributions of works of art, historical treasures, and similar assets if the donated items are added to collections that meet all of the following conditions:

a. Are held for public exhibition, education, or research in furtherance of public service rather than financial gain
b. Are protected, kept unencumbered, cared for, and preserved

c. Are subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

12. For purposes of initial application of this Statement, entities are encouraged either to capitalize retroactively collections acquired in previous periods or to capitalize collections on a prospective basis. Capitalization of selected collections or items is precluded.

13. Contributed collection items shall be recognized as revenues or gains if collections are capitalized and shall not be recognized as revenues or gains if collections are not capitalized. An entity that does not recognize and capitalize its collections or that capitalizes collections prospectively shall disclose the additional information required by paragraphs 26 and 27.

**Reporting by Not-for-Profit Organizations**

14. A not-for-profit organization shall distinguish between contributions received with permanent restrictions, those received with temporary restrictions, and those received without donor-imposed restrictions. A restriction on an organization’s use of the assets contributed results either from a donor’s explicit stipulation or from circumstances surrounding the receipt of the contribution that make clear the donor’s implicit restriction on use. Contributions with donor-imposed restrictions shall be reported as restricted support; however, donor-restricted contributions whose restrictions are met in the same reporting period may be reported as unrestricted support provided that an organization reports consistently from period to period and discloses its accounting policy. Restricted support increases permanently restricted net assets or temporarily restricted net assets. Contributions without donor-imposed restrictions shall be reported as unrestricted support that increases unrestricted net assets.

15. Receipts of unconditional promises to give with payments due in future periods shall be reported as restricted support unless explicit donor stipulations or circumstances surrounding the receipt of a promise make clear that the donor intended it to be used to support activities of the current period. For example, receipts of unconditional promises to give cash in future years generally increase temporarily restricted net assets.

16. Gifts of long-lived assets received without stipulations about how long the donated asset must be used shall be reported as unrestricted support if it is an organization’s accounting policy to imply a time restriction that expires over the useful life of the donated assets. Organizations that adopt a policy of implying time restrictions also shall imply a time restriction on long-lived assets acquired with gifts of cash or other assets restricted for those acquisitions. In the absence of that policy and other donor-imposed restrictions on use of the asset, gifts of long-lived assets shall be reported as unrestricted support. An organization shall disclose its accounting policy.

**Expiration of Donor-imposed Restrictions**

17. A not-for-profit organization shall recognize the expiration of a donor-imposed restriction on a contribution in the period in which the restriction expires. A restriction expires when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. If an expense is incurred for a purpose for which both unrestricted and temporarily restricted net assets are available, a donor-imposed restriction is fulfilled to the extent of the expense incurred unless the expense is for a purpose that is directly attributable to another specific external source of revenue. For example, an expense does not fulfill an existing donor restriction if that expense is incurred for a purpose that is directly attributable to and reimbursed by a sponsored exchange agreement or a conditional award from a government agency, private foundation, or others. Pursuant to paragraph 19 of Statement 117, expirations of donor-imposed restrictions that simultaneously increase one class of net assets and decrease another (reclassifications) are reported separately from other transactions.

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4Collections of works of art, historical treasures, and similar assets acquired in previous periods but not capitalized as assets may be retroactively capitalized at their cost or fair value at date of acquisition, current cost, or current market value, whichever is deemed most practical.

5If two or more temporary restrictions are imposed on a contribution, the effect of the expiration of those restrictions is recognized in the period in which the last remaining restriction has expired. Temporarily restricted net assets with time restrictions are not available to support expenses until the time restrictions have expired. Time restrictions implied on gifts of long-lived assets expire as the economic benefits of the acquired assets are used up; that is, over their estimated useful lives. In the absence of donor stipulations specifying how long donated assets must be used or an organization’s policy of implying time restrictions, restrictions on long-lived assets, if any, or cash to acquire long-lived assets expire when the assets are placed in service.
tion in financial statements, the Board’s assessment of the costs and benefits is unavoidably subjective. Moreover, because the costs to implement a new standard are not borne directly by those who derive the benefits of the improved reporting, the Board must balance the diverse and often conflicting needs of preparers, investors, donors, creditors, and others who use financial statements.

47. The Board believes that the incremental costs of the requirements of this Statement have been reduced in various ways: by not requiring contributions of works of art, historical treasures, and similar items to be capitalized if they are held in collections as defined; by restricting the criteria for recognition of contributed services; by allowing prospective application of provisions for expirations of restrictions; by extending the effective date of this Statement; and by allowing an additional one-year extension for small not-for-profit organizations. Reducing some of the incremental costs of the requirements of this Statement in those ways may reduce some of the benefits and possibly increase other costs. For example, allowing alternatives to capitalization of collections may increase the costs incurred by users of financial statements as they evaluate differing information about those items. The Board concluded that the overall benefits of the information provided by applying this Statement justify the costs of complying with these standards.

### Distinguishing Contributions from Other Transactions

48. The Board focused on three characteristics that help distinguish contributions from other transactions—contributions (a) are nonreciprocal transfers, (b) are transfers to or from entities acting other than as owners, and (c) are made or received voluntarily. Those characteristics distinguish contributions from exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately equal value; from investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners; and from other nonreciprocal transfers, such as impositions of taxes or fines and thefts, which are not voluntary transfers.

### Distinguishing Contributions from Exchange Transactions

49. Because some exchange transactions may appear to be much like contributions, a careful assessment of the characteristics of the transaction is required to determine whether the recipient of a transfer of assets has given up an asset or incurred a liability of commensurate value. The Board believes that assessing the characteristics of transactions from the perspectives of both the resource provider and the recipient is necessary to determine whether a contribution has occurred.

50. For example, a resource provider may sponsor research and development activities at a research university and retain proprietary rights or other privileges, such as patents, copyrights, or advance and exclusive knowledge of the research outcomes. The research outcomes may be intangible, uncertain, or difficult to measure, and may be perceived by the university as a sacrifice of little or no value; however, their value often is commensurate with the value that a resource provider expects in exchange. Similarly, a resource provider may sponsor research and development activities and specify the protocol of the testing so the research outcomes are particularly valuable to the resource provider. Those transactions are not contributions if their potential public benefits are secondary to the potential proprietary benefits to the resource providers.

51. Moreover, a single transaction may be in part an exchange and in part a contribution. For example, if a donor transfers a building to an entity at a price significantly lower than its market value and no unstated rights or privileges are involved, the transaction is in part an exchange of assets and in part a contribution to be accounted for as required by this Statement.

### Distinguishing Contributions from Agency and Similar Transactions

52. A transfer of assets also may appear to be a contribution when a donor uses an intermediary organization as its agent or trustee to transfer assets to a third-party donee, particularly if the agent indirectly achieves its mission by disbursing the assets. Although the transaction between the donor and the donee may be a contribution, the transfer of assets from the donor is not a contribution received by the agent, and the transfer of assets to the donee is not a contribution made by the agent.

53. The recipient of assets who is an agent or trustee has little or no discretion in determining how the assets transferred will be used. For example, if a recipient receives cash that it must disburse to anyone who meets guidelines specified by a resource provider or return the cash, those receipts may be deposits held by the recipient as an agent rather than contributions received as a donee. Similarly, if a recipient receives cash that it must disburse to individuals identified by the resource provider or return the cash, neither the receipt nor the disbursement is a contribution for the agent, trustee, or intermediary.

54. In contrast, if the resource provider allows the recipient to establish, define, and carry out the programs that disburse the cash, products, or services to the recipient’s beneficiaries, the recipient generally is involved in receiving and making contributions.
Exclusion of Certain Transactions

55. Some respondents to the 1990 Exposure Draft asked whether the scope of this Statement was intended to include accounting for certain transfers that might be considered both voluntary and nonreciprocal, such as tax incentives, tax abatements, and transfers of land, buildings, or other assets by governments to entice businesses to their communities. The Board concluded that those transactions present specific complexities that may need special study and therefore excluded them from the scope of this Statement.

56. Some respondents to the 1992 Exposure Draft asked the Board to exclude all governmental transfers. Many colleges and universities, in particular, said determining whether specific grants, appropriations, loan guarantees, and similar governmental transfers are exchange transactions or are voluntary and nonreciprocal transfers—contributions—is difficult and often arbitrary. Some asserted that governmental transfers are never voluntary contributions. They suggested that all governmental transfers be reported as a separate category of revenue and be excluded from the scope of this Statement to allow their industry associations or the AICPA to provide industry-specific guidance. The Board believes that whether a grant is from a government agency, private foundation, or corporation, the difficulties in determining whether a transfer is an exchange transaction or a contribution are substantially the same. The Board acknowledges that to apply the provisions of this Statement requires a careful assessment of the characteristics of the transfers as discussed in paragraphs 48-54; however, it concluded that excluding all governmental transfers is neither necessary nor desirable because that would further delay improvements to practice.

Distinguishing Donor-imposed Restrictions from Conditions

57. This Statement distinguishes between unrestricted gifts, restricted gifts, and transfers of cash or other assets with conditions, which are similar to conditional promises to give. A donor-imposed restriction limits the use of donated assets; however, a condition creates a barrier that must be overcome before assets transferred or promised become contributions received or made. The distinction between a restriction and a condition, although clear in concept, sometimes is obscure in practice.

58. The Board concluded that a donor-imposed restriction, which limits or directs the use of donated assets, is not fundamentally different from an explicit or implied stipulation that donated assets be used to support an organization’s broad charitable, educational, religious, or similar purposes. Both are expressions or directives that the donated assets be used to support an organization’s activities, and both are gifts that increase the organization’s capacity to provide services. A donor’s directive may be more prescriptive; for example, that donated assets be used to support a particular program service, to support the acquisition of long-lived assets, or to create a permanent endowment or term-endowment fund. That prescription, however, does not change the fundamental and underlying event—the voluntary nonreciprocal transfer of economic benefits from a donor to a donee.

59. The Board also concluded that although an unrestricted gift and a restricted gift are similar events, information about the nature and extent of donor-imposed restrictions is relevant to users of financial statements (paragraphs 145-148). A donor-imposed restriction imposes special responsibilities on the management of an organization to ensure that it uses donated assets as stipulated. The limits imposed by those restrictions may impinge upon an organization’s performance and its ability to provide a satisfactory level of services.

60. The Board concluded that a transfer of cash or other assets with a stipulation that the assets be returned if a specified future and uncertain event occurs or fails to occur is fundamentally different from both an unrestricted gift and a restricted gift. Imposing a condition creates a barrier that must be overcome before the recipient of the transferred assets has an unconditional right to retain those promised assets. For example, a transfer of cash with a promise to contribute that cash if a like amount of new gifts are raised from others within 30 days and a provision that the cash be returned if the gifts are not raised imposes a condition on which a promised gift depends.

61. By imposing a condition, the transferor of assets not only retains a right of return of the transferred assets, but also casts doubt on whether the intent of the transfer was to make a gift, to conditionally promise a gift, or, at the extreme, not to make a gift. Because donors impose very different kinds of conditions, the likelihood of meeting a condition can range from probable to remote. The Board concluded that if a transferor imposes a condition, a reasonable possibility exists that the condition will not occur and the transferred assets will be returned and, thus, should be accounted for as a refundable advance.

62. Some respondents to the 1992 Exposure Draft, particularly foundations, said this Statement should make clear whether imposing administrative requirements, such as requiring routine annual reporting as a “condition” of a multiyear grant, would preclude recognition of an otherwise unconditional promise to give. Some also expressed concern that donors and donees may avoid recognition of unconditional promises to give by adding trivial conditions or requesting that they be
(8) Support from a governmental unit.

(i) For purposes of subparagraphs (2) and (3)(i) of this paragraph, the term "support from a governmental unit" includes any amounts received from a governmental unit, including donations or contributions and amounts received in connection with a contract entered into with a governmental unit for the performance of services or in connection with a Government research grant. However, such amounts will not constitute "support from a governmental unit" for such purposes if they constitute amounts received from the exercise or performance of the organization's exempt functions as provided in subparagraph (7)(i)(a) of this paragraph.

(ii) For purposes of subdivision (i) of this subparagraph, any amount paid by a governmental unit to an organization is not to be treated as received from the exercise or performance of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a) (within the meaning of subparagraph (7)(i)(a) of this paragraph) if the purpose of the payment is primarily to enable the organization to provide a service to, or maintain a facility for, the direct benefit of the public (regardless of whether part of the expense of providing such service or facility is paid for by the public), rather than to serve the direct and immediate needs of the payor. For example:

(a) Amounts paid for the maintenance of library facilities which are open to the public.

(b) Amounts paid under Government programs to nursing homes or homes for the aged in order to provide health care or domiciliary services to residents of such facilities, and

(c) Amounts paid to child placement or child guidance organizations under Government programs for services rendered to children in the community,

are considered payments the purpose of which is primarily to enable the recipient organization to provide a service or maintain a facility for the direct benefit of the public, rather than to serve the direct and immediate needs of the payor. Furthermore, any amount received from a governmental unit under circumstances such that the amount would be treated as a "grant" within the meaning of section 1.509(a)-3(g) will generally constitute "support from a governmental unit" described in this subdivision, rather than an amount described in subparagraph (7)(i)(a) of this paragraph.

(9) Examples. The application of subparagraphs (1) through (8) of this paragraph may be illustrated by the following examples:

Example 1.
(a) M is an organization referred to in section 170(c)(2). For the years 1970 through 1973 (the applicable period with respect to the taxable year 1974 under subparagraph (4) of this paragraph), M received support (as defined in subparagraphs (6) through (8) of this paragraph) of $600,000 from the following sources:

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment income</td>
<td>$300,000</td>
</tr>
<tr>
<td>City Y (a governmental unit referred to in section 170(c)(1))</td>
<td>$40,000</td>
</tr>
<tr>
<td>United Fund (an organization referred to in section 170(b)(1)(A)(vi))</td>
<td>$40,000</td>
</tr>
<tr>
<td>Contributions</td>
<td>$220,000</td>
</tr>
</tbody>
</table>

**Total support** $600,000

(b) With respect to the taxable year 1974, M "normally" received in excess of 33 1/3 percent of its support from a governmental unit referred to in section 170(c)(1) and from direct and indirect contributions from the general public (as defined in subparagraph (6) of this paragraph) computed as follows:

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>33 1/3 percent of total support</td>
<td>$200,000</td>
</tr>
<tr>
<td>Support from a governmental unit referred to in section 170(c)(1)</td>
<td>$40,000</td>
</tr>
<tr>
<td>Indirect contributions from the general public (United Fund)</td>
<td>$40,000</td>
</tr>
<tr>
<td>Contributions by various donors (no one having made contributions which total in excess of $12,000--2 percent of total support)</td>
<td>$50,000</td>
</tr>
<tr>
<td>Six contributions (each in excess of $12,000--2 percent total support)</td>
<td>$72,000</td>
</tr>
<tr>
<td>6 x $12,000</td>
<td>$72,000</td>
</tr>
</tbody>
</table>

**Total** $202,000

(c) Since the amount of X's support from governmental units referred to in section 170(c)(1) and from direct and indirect contributions from the general public with respect to the taxable year 1974 "normally" exceeds 33 1/3 percent of M's total support for the applicable period (1970-73), X meets the 33 1/3 percent-of-support test under subparagraph (2) of this paragraph and is therefore treated as satisfying the requirements for classification as a "publicly supported" organization under subparagraph (2) of this paragraph for the taxable years 1974 and 1975 (there being no substantial and material changes in the organization's character, purposes, methods of operation, or sources of support in these years).

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Example 2. N is an organization referred to in section 170(c)(2). It was created to maintain public gardens containing botanical specimens and displaying statuary and other art objects. The facilities, works of art, and a large endowment were all contributed by a single contributor. The members of the governing body of the organization are unrelated to its creator. The gardens are open to the public without charge and attract a substantial number of visitors each year. For the 4 taxable years immediately preceding the current taxable year, 95 percent of the organization's total support was received from investment income from its original endowment. N also maintains a membership society which is supported by members of the general public who wish to contribute to the upkeep of the gardens by paying a small annual membership fee. Over the 4-year period in question, these fees from the general public constituted the remaining 5 percent of the organization's total support for such period. Under these circumstances, N does not meet the 33 1/3 percent-of-support test under subparagraph (2) of this paragraph for its current taxable year. Furthermore, since only 5 percent of its total support is, with respect to the current taxable year, normally received from the general public, N does not satisfy the 10 percent-of-support limitation described in subparagraph (3)(i) of this paragraph and cannot therefore be classified as "publicly supported" under subparagraph (3) of this paragraph. For its current taxable year, N therefore, is not an organization described in section 170(b)(1)(A)(vi). Since N has failed to satisfy the 10 percent-of-support limitation under subparagraph (3)(i) of this paragraph, none of the other requirements or factors set forth in subparagraph (3)(iii) through (vii) of this paragraph can be considered in determining whether N qualifies as a "publicly supported" organization.

Example 3.

(a) O, an art museum, is an organization referred to in section 170(c)(2). In 1930, O was founded in Y City by the members of a single family to collect, preserve, interpret, and display to the public important works of art. O is governed by a Board of Trustees which originally consisted almost entirely of members of the founding family. However, since 1945, members of the founding family or persons standing in a relationship to the members of such family described in section 4946(a)(1)(C) through (G) have annually constituted less than one-fifth of the Board of Trustees. The remaining board members are citizens of Y City from a variety of professions and occupations who represent the interests and views of the people of Y City in the activities carried on by the organization rather than the personal or private interests of the founding family. O solicits contributions from the general public and for each of its 4 most recent taxable years has received total contributions (in small sums of less than $100, none of which exceeds 2 percent of O's total support for such period) in excess of $10,000. These contributions from the general public (as defined in subparagraph (6) of this paragraph) represent 25 percent of the organization's total support for such 4-year period. For this same period, investment income from several large endowment funds has constituted 75 percent of its total support. O expends substantially all of its annual income for its exempt purposes and thus depends upon the funds it
annually solicits from the public as well as its investment income in order to carry out its activities on a normal and continuing basis and to acquire new works of art. O has, for the entire period of its existence, been open to the public and more than 300,000 people (from Y City and elsewhere) have visited the museum in each of its four most recent taxable years.

(b) Under these circumstances, O does not meet the 33 1/3 percent-of-support test under subparagraph (2) of this paragraph for its current year since it has received only 25 percent of its total support for the applicable 4-year period from the general public. However, under the facts set forth above, O has met the 10 percent-of-support limitation under subparagraph (3)(i), as well as the requirements of subparagraph (3)(ii), of this paragraph. Under all of the facts set forth in this example, O is considered as meeting the requirements of subparagraph (3) of this paragraph on the basis of satisfying subparagraph (3) (i) and (ii) of this paragraph and the factors set forth in subparagraph (3) (iii), (iv), (v), and (vi) of this paragraph, and is therefore classified as a "publicly supported organization" under subparagraph (1) of this paragraph for its current taxable year and the immediately succeeding taxable year (there being no substantial and material changes in the organization's character, purposes, methods of operation, or sources of support in these years).

Example 4.

(a) In 1960, the P Philharmonic Orchestra was organized in Z City through the combined efforts of a local music society and a local women's club to present to the public a wide variety of musical programs intended to foster music appreciation in the community. P is an organization referred to in section 170(c)(2). The orchestra is composed of professional musicians who are paid by the association. Twelve performances open to the public are scheduled each year. A small admission charge is made for each of these performances. In addition, several performances are staged annually without charge. During its 4 most recent taxable years, P has received separate contributions of $200,000 each from A and B (not members of a single family) and support of $120,000 from the Z Community Chest, a public federated fund-raising organization operating in Z City. P depends on these funds in order to carry out its activities and will continue to depend on contributions of this type to be made in the future. P has also begun a fund-raising campaign in an attempt to expand its activities for the coming years. P is governed by a Board of Directors comprised of five individuals. A faculty member of a local college, the president of a local music society, the head of a local banking institution, a prominent doctor, and a member of the governing body of the local chamber of commerce currently serve on the Board and represent the interests and views of the community in the activities carried on by P.

(b) With respect to P's current taxable year, P's sources of support are computed on the basis of the 4 immediately preceding years, as follows:

| Contributions | $520,000 |

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Receipts from performances                100,000
--------
Total support                       620,000

Less:
Receipts from performances
(excluded under subparagraph
(7)(i)(a) of this paragraph)           100,000

Total support for purposes of
subparagraphs (2) and (3)(i)
of this paragraph                      520,000

(c) For purposes of subparagraphs (2) and (3)(i) of this paragraph, P's support is computed as follows:

Z Community Chest (indirect support
from the general public)                   $120,000

Two contributions (each in excess
of $10,400--2 percent of total support)
2 x $10,400                                  20,800
--------
Total                                    140,800

(d) P's support from the general public, directly and indirectly, does not meet the 33 1/3 percent-of-support test under subparagraph (2) of this paragraph ($140,800/$520,000=27 percent of total support). However, since P receives 27 percent of its total support from the general public, it meets the 10 percent-of-support limitation under subparagraph (3)(i) of this paragraph. P also meets the requirements of subparagraph (3)(ii) of this paragraph. As a result of satisfying these requirements and the factors set forth in subparagraph (3) (iii), (iv), (v), and (vi) of this paragraph, P is considered as meeting the requirements of subparagraph (3) of this paragraph and is therefore considered to be a "publicly supported" organization under subparagraph (1) of this paragraph.

(e) If, instead of the above facts, P were a newly created organization, P could obtain a ruling pursuant to subparagraph (5) of this paragraph by reason of its purposes, organizational structure and proposed method of operation. Even if P had initially been founded by the contributions of a few individuals, such fact would not, in and of itself, disqualify P from receiving a ruling under subparagraph (5) of this paragraph.

Example 5.

(a) Q is an organization referred to in section 170(c)(2). It is a philanthropic organization founded in 1965 by A for the purpose of making annual contributions to worthy charities. A
created Q as a charitable trust by the transfer of $500,000 worth of appreciated securities to Q. Pursuant to the trust agreement, A and two other members of his family are the sole trustees and are vested with the right to appoint successor trustees. In each of its four most recent taxable years, Q received $15,000 in investment income from its original endowment. Each year Q makes a solicitation for funds by operating a charity ball at A's residence. Guests are invited and requested to make contributions of $100 per couple. During the 4-year period involved, $15,000 was received from the proceeds of these events. A and his family have also made contributions to Q of $25,000 over the course of the organization's 4 most recent taxable years. Q makes disbursements each year of substantially all of its net income to the public charities chosen by the trustees.

(b) With respect to Q's current taxable year, Q's sources of support are computed on the basis of the 4 immediately preceding years as follows:

<table>
<thead>
<tr>
<th>Source of Support</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment income</td>
<td>$60,000</td>
</tr>
<tr>
<td>Contributions</td>
<td>40,000</td>
</tr>
<tr>
<td><strong>Total support</strong></td>
<td><strong>100,000</strong></td>
</tr>
</tbody>
</table>

(c) For purposes of subparagraphs (2) and (3)(i) of this paragraph, Q's support is computed as follows:

<table>
<thead>
<tr>
<th>Source of Support</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions from the general public</td>
<td>$15,000</td>
</tr>
<tr>
<td>One contribution (in excess of $2,000--2 percent of total support)</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>17,000</strong></td>
</tr>
</tbody>
</table>

(d) Q's support from the general public does not meet the 33 1/3 percent-of-support test under subparagraph (2) of this paragraph ($17,000/$100,000=17 percent of total support). Thus, Q's classification as a "publicly supported" organization depends on whether it meets the requirements of subparagraph (3) of this paragraph. Even though it satisfies the 10 percent-of-support limitation under subparagraph (3)(i) of this paragraph, its method of solicitation makes it questionable whether Q satisfies the requirements of subparagraph (3)(ii) of this paragraph. Because of its method of operating, Q also has a greater burden of establishing its publicly supported nature under subparagraph (3)(iii) of this paragraph. Based upon the foregoing and upon Q's failure to receive favorable consideration under the factors set forth in subparagraph (3)(iv), (v), and (vi) of this paragraph, Q does not satisfy the requirements of subparagraph (3) of this paragraph as a "publicly supported" organization.

(e) If, instead of the above facts, Q were a newly created organization, Q would not be able to
receive a ruling pursuant to subparagraph (5) of this paragraph. Its purposes, organizational structure, and method of operation would be insufficient to establish that Q could reasonably be expected to meet the requirements of subparagraph (2) or (3) of this paragraph for its first 2 or its first 5 taxable years.
(f) Gifts and contributions distinguished from gross receipts--

(1) In general.

In determining whether an organization normally receives more than one-third of its support from permitted sources, all gifts and contributions (within the meaning of section 509(a)(2)(A)(i)) received from permitted sources, are includible in the numerator of the support fraction in each taxable year. However, gross receipts (within the meaning of section 509(a)(2)(A)(ii)) from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business, are includible in the numerator of the support fraction in any taxable year only to the extent that such gross receipts do not exceed the limitation with respect to the greater of $5,000 or 1 percent of support which is describing paragraph (b) of this section. The terms gifts and contributions shall, for purposes of section 509(a)(2), have the same meaning as such terms have under section 170(c) and also include bequests, legacies, devises, and transfers within the meaning of section 2055 or 2106(a)(2). Thus, for purposes of section 509(a)(2)(A), any payment of money or transfer of property without adequate consideration shall be considered a gift or contribution. Where payment is made or property transferred as consideration for admissions, sales of merchandise, performance of services, or furnishing of facilities to the donor, the status of the payment or transfer under section 170(c) shall determine whether and to what extent such payment or transfer constitutes a gift or contribution under section 509(a)(2)(A)(i) as distinguished from gross receipts from related activities under section 509(a)(2)(A)(ii). For purposes of section 509(a)(2), the term contributions includes qualified sponsorship payments (as defined in §1.513-4) in the form of money or property (but not services).

(2) Valuation of property.

For purposes of section 509(a)(2), the amount includible in computing support with respect to gifts, grants or contributions of property or use of such property shall be the fair market or rental value of such property at the date of such gift or contribution.

(3) Examples. The provisions of this paragraph (f) may be illustrated by the following examples:

**Example 1.** P is a local agricultural club described in section 501(c)(3). In order to encourage interest and proficiency by young people in farming and raising livestock, it makes awards at its annual fair for outstanding specimens of produce and livestock. Most of these awards are cash or other property donated by local businessmen. When the awards are made, the donors are given recognition for their donations by being identified as the donor of the award. The recognition given to donors is merely incidental to the making of the award to worthy youngsters. For these reasons, the donations will constitute contributions for purposes of section 509(a)(2)(A)(i). The amount includible in...
computing support with respect to such contributions is equal to the cash contributed or the fair market value of other property on the dates contributed.

Example 2. Q, a performing arts center, enters into a contract with a large company to be the exclusive sponsor of the center's theatrical events. The company makes a payment of cash and products in the amount of $100,000 to Q, and in return, Q agrees to make a broadcast announcement thanking the company before each show and to provide $2,000 of advertising in the show's program (2% of $100,000 is $2,000). The announcement constitutes use or acknowledgment pursuant to section 513(i)(2). Because the value of the advertising does not exceed 2% of the total payment, the entire $100,000 is a qualified sponsorship payment under section 513(i), and $100,000 is treated as a contribution for purposes of section 509(a)(2)(A)(i).

Example 3. R, a charity, enters into a contract with a law firm to be the exclusive sponsor of the charity's outreach program. Instead of making a cash payment, the law firm agrees to perform $100,000 of legal services for the charity. In return, R agrees to acknowledge the law firm in all its informational materials. The total fair market value of the legal services, or $100,000, is a qualified sponsorship payment under section 513(i), but no amount is treated as a contribution under section 509(a)(2)(A)(i) because the contribution is of services.

(g) Grants distinguished from gross receipts--

(1) In general.

In determining whether an organization normally receives more than one-third of its support from public sources, all grants (within the meaning of section 509(a)(2)(A)(i)) received from permitted sources are includible in full in the numerator of the support fraction in each taxable year. However, gross receipts (within the meaning of section 509(a)(2)(A)(ii)) from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business, are includible in the numerator of the support fraction in any taxable year only to the extent that such gross receipts do not exceed the limitation with respect to the greater of $5,000 or 1 percent of support which is described in paragraph (b) of this section. A grant is normally made to encourage the grantee organization to carry on certain programs or activities in furtherance of its exempt purposes. It may contain certain terms and conditions imposed by the grantor to insure that the grantee's programs or activities are conducted in a manner compatible with the grantor's own programs and policies and beneficial to the public. The grantee may also perform a service or produce a work product which incidentally benefits the grantor. Because of the imposition of terms and conditions, the frequent similarity of public purposes of grantor and grantee, and the possibility of benefit resulting to the grantor, amounts received as grants for the carrying
on of exempt activities are sometimes difficult to distinguish from amounts received as gross receipts from the carrying on of exempt activities. The fact that the agreement, pursuant to which payment is made, is designated a contract or a grant is not controlling for purposes of classifying the payment under section 509(a)(2).

(2) Distinguishing factors.

For purposes of section 509(a)(2)(A)(ii), in distinguishing the term gross receipts from the term grants, the term gross receipts means amounts received from an activity which is not an unrelated trade or business, if a specific service, facility, or product is provided to serve the direct and immediate needs of the payor, rather than primarily to confer a direct benefit upon the general public. In general, payments made primarily to enable the payor to realize or receive some economic or physical benefit as a result of the service, facility, or product obtained will be treated as gross receipts with respect to the payee. The fact that a profitmaking organization would, primarily for its own economic or physical betterment, contract with a nonprofit organization for the rendition of a comparable service, facility or product from such organization constitutes evidence that any payments received by the nonprofit payee organization (whether from a governmental unit, a nonprofit or a profitmaking organization) for such services, facilities or products are primarily for the economic or physical benefit of the payor and would therefore be considered gross receipts, rather than grants with respect to the payee organization. For example, if a nonprofit hospital described in section 170(b)(1)(A)(iii) engages an exempt research and development organization to develop a more economical system of preparing food for its own patients and personnel, and it can be established that a hospital operated for profit might engage the services of such an organization to perform a similar benefit for its economic betterment, such fact would constitute evidence that the payments received by the research and development organization constitute gross receipts, rather than grants. Research leading to the development of tangible products for the use or benefit of the payor will generally be treated as a service provided to serve the direct and immediate needs of the payor, while basic research or studies carried on in the physical or social sciences will generally be treated as primarily to confer a direct benefit upon the general public.

(3) Examples.

The application of this paragraph may be illustrated by the following examples:

Example 1. M, a nonprofit research organization described in section 501(c)(3), engages in some contract research. It receives funds from the government to develop a specific electronic device needed to perfect articles of space equipment. The initiative for the project came solely from the government. Furthermore, the government could have contracted with profitmaking research organizations which carry on similar activities. The funds received from the government for this project are gross receipts and do not
constitute grants within the meaning of section 509(a)(2)(A)(i). M provided a specific product at the government's request and thus was serving the direct and immediate needs of the payor within the meaning of subparagraph (2) of this paragraph.

**Example 2.** N is a nonprofit educational organization described in section 501(c)(3). Its principal activity is to operate institutes to train employees of various industries in the principles of management and administration. The government pays N to set up a special institute for certain government employees and to train them over a 2-year period. Management training is also provided by profitmaking organizations. The funds received are included as gross receipts. The particular services rendered were to serve the direct and immediate needs of the government in the training of its employees within the meaning of subparagraph (2) of this paragraph.

**Example 3.** The Office of Economic Opportunity makes a community action program grant to O, an organization described in section 509(a)(1). O serves as a delegate agency of OEO for purposes of financing a local community action program. As part of this program, O signs an agreement with X, an educational and charitable organization described in section 501(c)(3), to carry out a housing program for the benefit of poor families. Pursuant to this agreement, O pays X out of the funds provided by OEO to build or rehabilitate low income housing and to provide advisory services to other nonprofit organizations in order for them to meet similar housing objectives, all on a nonprofit basis. Payments made from O to X constitute grants for purposes of section 509(a)(2)(A) because such program is carried on primarily for the direct benefit of the community.

**Example 4.** P is an educational institute described in section 501(c)(3). It carries on studies and seminars to assist institutions of higher learning. It receives funds from the government to research and develop a program of black studies for institutions of higher learning. The performance of such a service confers a direct benefit upon the public. Because such program is carried on primarily for the direct benefit of the public, the funds are considered a grant.

**Example 5.** Q is an organization described in section 501(c)(3) which carries on medical research. Its efforts have primarily been directed toward cancer research. Q sought funds from the government for a particular project being contemplated in connection with its work. In order to encourage its activities, the government gives Q the sum of $25,000. The research project sponsored by government funds is primarily to provide direct benefit to the general public, rather than to serve the direct and immediate needs of the government. The funds are therefore considered a grant.

**Example 6.** R is a public service organization described in section 501(c)(3) and composed of State and local officials involved in public works activities. The Bureau of Solid Waste, Management of the Department of Health, Education, and Welfare paid R to study the feasibility of a particular system for disposal of solid waste. Upon completion
of the study, R was required to prepare a final report setting forth its findings and conclusions. Although R is providing the Bureau of Solid Waste Management with a final report, such report is the result of basic research and study in the physical sciences and is primarily to provide direct benefit to the general public by serving to further the general functions of government, rather than a direct and immediate governmental needs. The funds paid to R are therefore a grant within the meaning of section 509(a)(2).

Example 7. R is the public service organization referred to in example (6). W, a municipality described in section 170(c)(1), decides to construct a sewage disposal plant. W pays R to study a number of possible locations for such plant and to make recommendations to W, based upon a number of factors, as to the best location. W instructed R that in making its recommendation, primary consideration should be given to minimizing the costs of the project to W. Since the study commissioned by W was primarily directed toward producing an economic benefit to W in the form of minimizing the costs of its project, the services rendered are treated as serving W's direct and immediate needs and are includible as gross receipts by R.

Example 8. S in an organization described in section 501(c)(3). It was organized and is operated to further African development and strengthen understanding between the United States and Africa. To further these purposes, S receives funds from the Agency for International Development and the Department of State under which S is required to carry out the following programs: Selection, transportation, orientation, counseling, and language training of African students admitted to American institutions of higher learning; payment of tuition, other fees, and maintenance of such students; and operation of schools and vocational training programs in underdeveloped countries for residents of those countries. Since the programs carried on by S are primarily to provide direct benefit to the general public, all of the funds received by S from the Federal agencies are considered grants within the meaning of section 509(a)(2).