

(ii) The 91st day after the date an organization receives a final ruling or determination letter that it is a private foundation under section 509(a).

[T.D. 7232, 37 FR 28292, Dec. 22, 1972, as amended by T.D. 7440, 41 FR 50656, Nov. 17, 1976; T.D. 7678, 45 FR 12415, Feb. 26, 1980]

**§ 1.508-4 Effective date.**

Except as otherwise provided, §§ 1.508-1 through 1.508-3 shall take effect on January 1, 1970.

(Sec. 7805 of the Internal Revenue Code of 1954, 68A Stat. 917; 26 U.S.C. 7805)

[T.D. 7232, 37 FR 28294, Dec. 22, 1972]

**§ 1.509(a)-1 Definition of private foundation.**

*In general.* Section 509(a) defines the term *private foundation* to mean any domestic or foreign organization described in section 501(c)(3) other than an organization described in section 509(a) (1), (2), (3), or (4). Organizations which fall into the categories excluded from the definition of *private foundation* are generally those which either have broad public support or actively function in a supporting relationship to such organizations. Organizations which test for public safety are also excluded.

[T.D. 7212, 37 FR 21907, Oct. 17, 1972]

**§ 1.509(a)-2 Exclusion for certain organizations described in section 170(b)(1)(A).**

(a) *General rule.* Organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) are excluded from the definition of *private foundation* by section 509(a)(1). For the requirements to be met by organizations described in section 170(b)(1)(A) (i) through (vi), see § 1.170A-9 (a) through (e) and paragraph (b) of this section. For purposes of this section, the parenthetical language *other than in clauses (vii) and (viii)* used in section 509(a)(1) means *other than an organization which is described only in clause (vii) or (viii)*. For purposes of this section, an organization may qualify as a section 509(a)(1) organization regardless of the fact that it does not satisfy section 170(c)(2) because:

(1) Its funds are not used within the United States or its possessions, or

(2) It was created or organized other than in, or under the law of, the United States, any State or territory, the District of Columbia, or any possession of the United States.

(b) *Medical research organizations.* In order to qualify under section 509(a)(1) as a medical research organization described in section 170(b)(1)(A)(iii), an organization must meet the requirements of section 170(b)(1)(A)(iii) and § 1.170A-9(c)(2), except that, solely for purposes of classification as a section 509(a)(1) organization, such organization need not be committed to spend every contribution for medical research before January 1 of the fifth calendar year which begins after the date such contribution is made.

[T.D. 7212, 37 FR 21907, Oct. 17, 1972]

**§ 1.509(a)-3 Broadly, publicly supported organizations.**

(a) *In general—(1) General rule.* Section 509(a)(2) excludes certain types of broadly, publicly supported organizations from private foundation status. An organization will be excluded under section 509(a)(2) if it meets the one-third support test under section 509(a)(2)(A) and the not-more-than-one-third support test under section 509(a)(2)(B).

(2) *One-third support test.* An organization will meet the one-third support test if it normally (within the meaning of paragraph (c), (d), or (e) of this section) receives more than one-third of its support in each taxable year from any combination of:

(i) Gifts, grants, contributions, or membership fees, and

(ii) Gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513), subject to certain limitations described in paragraph (b) of this section,

from permitted sources. For purposes of this section, governmental units, organizations described in section 509(a)(1) and persons other than disqualified persons with respect to the organization shall be referred to as permitted sources. For purposes of this section, the amount of support received

from the sources described in subdivisions (i) and (ii) of this subparagraph (subject to the limitations referred to in this subparagraph) will be referred to as the numerator of the one-third support total amount of support received (as defined in section 509(d)) will be referred to as the denominator of the one-third support fraction. For purposes of section 509(a)(2), paragraph (f) of this section distinguishes gifts and contributions from gross receipts; paragraph (g) of this section distinguishes grants from gross receipts; paragraph (h) of this section defines membership fees; paragraph (i) of this section defines *any bureau or similar agency of a governmental unit*; paragraph (j) of this section describes the treatment of certain indirect forms of support; paragraph (k) of this section describes the method of accounting for support; paragraph (l) of this section describes the treatment of gross receipts from section 513(a) (1), (2), or (3) activities; and paragraph (m) of this section distinguishes gross receipts from gross investment income.

(3) *Not-more-than-one-third support test*—(i) *In general.* An organization will meet the not-more-than-one-third support test under section 509(a)(2)(B) if it normally (within the meaning of paragraph (c), (d), or (e) of this section) receives not more than one-third of its support in each taxable year from the sum of its gross investment income (as defined in section 509(e)) and the excess (if any) of the amount of its unrelated business taxable income (as defined in section 512) derived from trades or businesses which were acquired by the organization after June 30, 1975, over the amount of tax imposed on such income by section 511. For purposes of this section the amount of support received from items described in section 509(a)(2)(B) will be referred to as the numerator of the not-more-than-one-third support fraction, and the total amount of support (as defined in section 509(d)) will be referred to as the denominator of the not-more-than-one-third support fraction. For purposes of section 509(a)(2), paragraph (m) of this section distinguishes gross receipts from gross investment income. For purposes of section 509(e), gross investment income includes the items of in-

vestment income described in § 1.512(b)-1(a).

(ii) *Trade or business.* For purposes of section 509(a)(2)(B)(ii), a trade or business acquired after June 30, 1975, by an organization shall include, in addition to other trades or businesses:

(A) A trade or business acquired after such date from, or as a result of the liquidation of, an organization's subsidiary which is described in section 502 whether or not the subsidiary was held on June 30, 1975.

(B) A new trade or business commenced by an organization after such date.

(iii) *Allocation of deductions between businesses acquired before, and businesses acquired after, June 30, 1975.* Deductions which are allowable under section 512 but are not directly connected to a particular trade or business, such as deductions referred to in paragraphs (10) and (12) of section 512(b), shall be allocated in the proportion that the unrelated trade or business taxable income derived from trades or businesses acquired after June 30, 1975, bears to the organization's total unrelated business taxable income, both amounts being determined without regard to such deductions.

(iv) *Allocation of tax.* The tax imposed by section 511 shall be allocated in the same proportion as in paragraph (a)(3)(iii) of this section.

(4) *Purposes.* The one-third support test and the not-more-than-one-third support test are designed to insure that an organization which is excluded from private foundation status under section 509(a)(2) is responsive to the general public, rather than to the private interests of a limited number of donors or other persons.

(b) *Limitation on gross receipts*—(1) *General rule.* In computing the amount of support received from gross receipts under section 509(a)(2)(A)(ii) for purposes of the one-third support test of section 509(a)(2)(A), gross receipts from related activities received from any person, or from any bureau or similar agency of a governmental unit, are includible in any taxable year only to the extent that such receipts do not exceed the greater of \$5,000 or 1 percent of the organization's support in such taxable year.

(2) *Examples.* The application of this paragraph may be illustrated by the examples set forth below. For purposes of these examples, the term *general public* is defined as persons other than disqualified persons and other than persons from whom the foundation receives gross receipts in excess of the greater of \$5,000 or 1 percent of its support in any taxable year, and the term *gross receipts* is limited to receipts from activities which are not unrelated trade or business (within the meaning of section 513).

*Example 1.* For the taxable year 1970, X, an organization described in section 501(c)(3), received support of \$10,000 from the following sources:

Bureau M (a governmental bureau from which X received gross receipts for services rendered)	\$25,000
Bureau N (a governmental bureau from which X received gross receipts for services rendered)	25,000
General public (gross receipts for services rendered)	20,000
Gross investment income	15,000
Contributions from individual substantial contributors (defined as disqualified persons under section 4946(a)(2))	15,000
Total support	100,000

Since the \$25,000 received from each bureau amounts to more than the greater of \$5,000 or 1 percent of X's support for 1970 (1% of \$100,000=\$1,000) under section 509(a)(2)(A)(ii), each amount is includible in the numerator of the one-third support fraction only to the extent of \$5,000. Thus, for the taxable year 1970, X received support from sources which are taken into account in meeting the one-third support test of section 509(a)(2)(A) computed as follows:

Bureau M	\$5,000
Bureau N	5,000
General public	20,000
Total	30,000

Therefore, in making the computations required under paragraph (c), (d), or (e) of this section, only \$30,000 is includible in the aggregate numerator and \$100,000 is includible in the aggregate denominator of the support fraction.

*Example 2.* For the taxable year 1970, Y, an organization described in section 501(c)(3), received support of \$600,000 from the following sources:

Bureau O (gross receipts for services rendered)	\$10,000
Bureau P (gross receipts for services rendered)	10,000
General public (gross receipts for services rendered)	150,000
General public (contributions)	40,000
Gross investment income	150,000
Contributions from substantial contributors	240,000
Total support	600,000

Since the \$10,000 received from each bureau amounts to more than the greater of \$5,000 or 1 percent of Y's support for 1970 (1% of \$600,000=\$6,000), each amount is includible in the numerator of the one-third support fraction only to the extent of \$6,000. Thus, for the taxable year 1970, Y received support from sources required to meet the one-third support test of section 509(a)(2)(A) computed as follows:

Bureau O	\$6,000
Bureau P	6,000
General public (gross receipts)	150,000
General public (contributions)	40,000
Total	202,000

Therefore, in making the computations required under paragraph (c), (d), or (e) of this section, \$202,000 is includible in the aggregate numerator and \$600,000 is includible in the aggregate denominator of the support fraction.

(c) *Normally—(1) In general—(i) Definition.* The support tests set forth in section 509(a)(2) are to be computed on the basis of the nature of the organization's *normal* sources of support. An organization will be considered as *normally* receiving one-third of its support from any combination of gifts, grants, contributions, membership fees, and gross receipts from permitted sources (subject to the limitations described in paragraph (b) of this section) and not more than one-third of its support from items described in section 509(a)(2)(B) for its current taxable year and the taxable year immediately succeeding its current year, if, for the 4 taxable years immediately preceding the current taxable year, the aggregate amount of the support received during the applicable period from gifts, grants, contributions, membership fees, and gross receipts from permitted sources (subject to the limitations described in paragraph (b) of this section) is more than one-third, and the aggregate amount of the support received from items described in section 509(a)(2)(B) is not more than one-third of the total support of the organization for such 4-year period.

(ii) *Exception for material changes in sources of support.* If for the current taxable year there are substantial and material changes in an organization's sources of support other than changes arising from unusual grants excluded under subparagraph (3) of this paragraph, then in applying subdivision (i)

of this subparagraph, neither the 4-year computation period, applicable to such year as an immediately succeeding taxable year, nor the 4-year computation period, applicable to such year as a current taxable year shall apply, and in lieu of such computation periods there shall be applied a computation period consisting of the taxable year of substantial and material changes and the 4 taxable years immediately preceding such year. Thus, for example, if there are substantial and material changes in an organization's sources of support for taxable year 1976, then even though such organization meets the requirements of subdivision (i) of this subparagraph based on a computation period of taxable years 1971 through 1974 or 1972 through 1975, such an organization will not meet the requirements of section 509(a)(2) unless it meets the requirements of subdivision (i) of this subparagraph for a computation period of the taxable years 1972 through 1976. See example 3 in subparagraph (6) of this paragraph for an illustration of this subdivision. An example of a substantial and material change is the receipt of an unusually large contribution or bequest which does not qualify as an unusual grant under subparagraph (3) of this paragraph. See subparagraph (5)(ii) of this paragraph as to the procedure for obtaining a ruling whether an unusually large grant may be excluded as an unusual grant.

(iii) *Status of grantors and contributors.* (a) If as a result of subdivision (ii) of this subparagraph, an organization is not able to meet the requirements of either the one-third support test described in paragraph (a)(2) of this section or the not-more-than-one-third support test described in paragraph (a)(3) of this section for its current taxable year, its status (with respect to a grantor or contributor under sections 170, 507, 545(b)(2), 556(b)(2), 642(c), 4942, 4945, 2055, 2106(a)(2), and 2522) will not be affected until notice of change of status under section 509(a)(2) is made to the public (such as by publication in the Internal Revenue Bulletin). The preceding sentence shall not apply, however, if the grantor or contributor was responsible for, or was aware of, the substantial and material change re-

ferred to in subdivision (ii) of this subparagraph, or acquired knowledge that the Internal Revenue Service had given notice to such organization that it would be deleted from classification as section 509(a)(2) organization.

(b) A grantor or contributor other than one of the organization's founders, creators, or foundation managers (within the meaning of section 4946(b)) will not be considered to be responsible for, or aware of, the substantial and material change referred to in subdivision (ii) of this subparagraph if such grantor or contributor has made such grant or contribution in reliance upon a written statement by the grantee organization that such grant or contribution will not result in the loss of such organization's classification as not a private foundation under section 509(a). Such statement must be signed by a responsible officer of the grantee organization and must set forth sufficient information, including a summary of the pertinent financial data for the 4 preceding years, to assure a reasonably prudent man that his grant or contribution will not result in the loss of the grantee organization's classification as not a private foundation under section 509(a). If a reasonable doubt exists as to the effect of such grant or contribution, or if the grantor or contributor is one of the organization's founders, creators, or foundation managers, the procedure set forth in subparagraph (5)(ii) of this paragraph may be followed by the grantee organization for the protection of the grantor or contributor.

(iv) *Special rule for new organizations.* If an organization has been in existence for at least 1 taxable year consisting of at least 8 months, but for fewer than 5 taxable years, the number of years for which the organization has been in existence immediately preceding each current taxable year being tested will be substituted for the 4-year period described in subdivision (i) of this subparagraph to determine whether the organization *normally* meets the requirements of paragraph (a) of this section. However, if subdivision (ii) of this subparagraph applies, then the period consisting of the number of years for

which the organization has been in existence (up to and including the current year) will be substituted for the 4-year period described in subdivision (i) of this subparagraph. An organization which has been in existence for at least 1 taxable year, consisting of 8 or more months, may be issued a ruling or determination letter if it *normally* meets the requirements of paragraph (a) of this section for the number of years described in this subdivision. Such an organization may apply for a ruling or determination letter under the provisions of this paragraph, rather than under the provisions of paragraph (d) of this section. The issuance of a ruling or determination letter will be discretionary with the Commissioner. See paragraph (e)(4) of this section as to the initial determination of the status of a newly created organization. This subdivision shall not apply to those organizations receiving an extended advance ruling under paragraph (d)(4) of this section.

(2) *Terminations under section 507(b)(1)(B).* For the special rules applicable to the term *normally* as applied to private foundations which elect to terminate their private foundation status pursuant to the 12-month or 60-month procedure provided in section 507(b)(1)(B), see the regulations under such section.

(3) *Exclusion of unusual grants.* For purposes of applying the 4-year aggregation test for support set forth in subparagraph (1) of this paragraph, one or more contributions (including contributions made prior to Jan. 1, 1970) may be excluded from the numerator of the one-third support fraction and from the denominator of both the one-third support and not-more-than-one-third support fractions only if such a contribution meets the requirements of this subparagraph. The exclusion provided by this subparagraph is generally intended to apply to substantial contributions and bequests from disinterested parties, which contributions or bequests:

- (i) Are attracted by reason of the publicly supported nature of the organization;
- (ii) Are unusual or unexpected with respect to the amount thereof; and

- (iii) Would by reason of their size, adversely affect the status of the organization as normally meeting the one-third support test for any of the applicable periods described in paragraph (c), (d), or (e) of this section.

In the case of a grant (as defined in paragraph (g) of this section) which meets the requirements of this subparagraph, if the terms of the granting instrument (whether executed before or after 1969) require that the funds be paid to the recipient organization over a period of years, the amount received by the organization each year pursuant to the terms of such grant may be excluded for such year. However, no item described in section 509(a)(2)(B) may be excluded under this subparagraph. The provisions of this subparagraph shall apply to exclude unusual grants made during any of the applicable periods described in paragraph (c), (d), or (e) of this section. See subparagraph (5)(ii) of this paragraph as to reliance by a grantee organization upon an unusual grant ruling under this subparagraph.

(4) *Determining factor.* In determining whether a particular contribution may be excluded under subparagraph (3) of this paragraph, all pertinent facts and circumstances will be taken into consideration. No single factor will necessarily be determinative. Among the factors to be considered are:

- (i) Whether the contribution was made by any person (or persons standing in a relationship to such person which is described in section 4946(a)(1)(C) through (G)) who created the organization, previously contributed a substantial part of its support or endowment, or stood in a position of authority, such as a foundation manager (within the meaning of section 4946(b)), with respect to the organization. A contribution made by a person other than those persons described in this subdivision will ordinarily be given more favorable consideration than a contribution made by a person described in this subdivision.

- (ii) Whether the contribution was a bequest or an inter vivos transfer. A bequest will ordinarily be given more favorable consideration than an inter vivos transfer.

- (iii) Whether the contribution was in the form of cash, readily marketable

securities, or assets which further the exempt purposes of the organization, such as a gift of a painting to a museum.

(iv) Except in the case of a new organization, whether, prior to the receipt of the particular contribution, the organization (a) has carried on an actual program of public solicitation and exempt activities and (b) has been able to attract a significant amount of public support.

(v) Whether the organization may reasonably be expected to attract a significant amount of public support subsequent to the particular contribution. In this connection, continued reliance on unusual grants to fund an organization's current operating expenses (as opposed to providing new endowment funds) may be evidence that the organization cannot reasonably be expected to attract future support from the general public.

(vi) Whether, prior to the year in which the particular contribution was received, the organization met the one-third support test described in subparagraph (1) of this paragraph without the benefit of any exclusions of unusual grants pursuant to subparagraph (3) of this paragraph;

(vii) Whether neither the contributor nor any person standing in a relationship to such contributor which is described in section 4946(a)(1) (C) through (G) continues directly or indirectly to exercise control over the organization;

(viii) Whether the organization has a representative governing body as described in § 1.509(a)-3(d)(3)(i); and

(ix) Whether material restrictions or conditions (within the meaning of § 1.507-2(a)(8)) have been imposed by the transferor upon the transferee in connection with such transfer.

(5) *Grantors and contributors.* (i) As to the status of grants and contributions which result in substantial and material changes in the organization (as described in subparagraph (1)(ii) of this paragraph) and which fail to meet the requirements for exclusion under subparagraph (3) of this paragraph, see the rules prescribed in subparagraph (1)(iii) of this paragraph.

(ii) Prior to the making of any grant or contribution which will allegedly meet the requirements for exclusion

under subparagraph (3) of this paragraph, a potential grantee organization may request a ruling whether such grant or contribution may be so excluded. Requests for such ruling may be filed by the grantee organization with the district director. The issuance of such ruling will be at the sole discretion of the Commissioner. The organization must submit all information necessary to make a determination of the applicability of subparagraph (3) of this paragraph, including all information relating to the factors described in subparagraph (4) of this paragraph. If a favorable ruling is issued, such ruling may be relied upon by the grantor or contributor of the particular contribution in question for purposes of sections 170, 507, 545(b)(2), 556(b)(2), 642(c), 4942, 4945, 2055, 2106(a)(2), and 2522 and by the grantee organization for purposes of subparagraph (3) of this paragraph.

(6) *Examples.* The application of the principles set forth in this paragraph is illustrated by the examples set forth below. For purposes of these examples, the term *general public* is defined as persons other than disqualified persons and other than persons from whom the foundation received gross receipts in excess of the greater of \$5,000 or 1 percent of its support in any taxable year, the term *gross investment income* is as defined in section 509(e), and the term *gross receipts* is limited to receipts from activities which are not unrelated trade or business (within the meaning of section 513).

*Example 1.* For the years 1970 through 1973, X, an organization exempt under section 501(c)(3) which makes scholarship grants to needy students of a particular city, received support from the following sources:

<i>1970</i>	
Gross receipts (general public) .....	\$35,000
Contributions (substantial contributors) .....	36,000
Gross investment income .....	29,000
<b>Total support .....</b>	<b>100,000</b>
<i>1971</i>	
Gross receipts (general public) .....	34,000
Contributions (substantial contributors) .....	35,000
Gross investment income .....	31,000
<b>Total support .....</b>	<b>100,000</b>
<i>1972</i>	
Gross receipts (general public) .....	35,000
Contributions (substantial contributors) .....	30,000
Gross investment income .....	35,000
<b>Total support .....</b>	<b>100,000</b>

1973	
Gross receipts (general public) .....	30,000
Contributions (substantial contributors) .....	39,000
Gross investment income .....	31,000
Total support .....	100,000

In applying section 509(a)(2) to the taxable year 1974 on the basis of subparagraph (1)(i) of this paragraph, the total amount of support from gross receipts from the general public (\$134,000) for the period 1970 through 1973 was more than one-third, and the total amount of support from gross investment income (\$126,000) was less than one-third, of its total support for the same period (\$400,000). For the taxable years 1974 and 1975, X is therefore considered *normally* to receive more than one-third of its support from the public sources described in section 509(a)(2)(A) and less than one-third of its support from items described in section 509(a)(2)(B) since due to the pattern of X's support, there are no substantial and material changes in the sources of the organization's support in these years. The fact that X received less than one-third of its support from section 509(a)(2)(A) sources in 1973 and more than one-third of its support from items described in section 509(a)(2)(B) in 1972 does not affect its status since it met the *normally* test over a 4-year period.

**Example 2.** Assume the same facts as in example 1 except that in 1973 X also received an unexpected bequest of \$50,000 from A, an elderly widow who was interested in encouraging the work of X, but had no other relationship to it. Solely by reason of the bequest, A became a disqualified person. X used the bequest to create five new scholarships. Its operations otherwise remained the same. Under these circumstances X could not meet the 4-year support test since the total amount received from gross receipts from the general public (\$134,000) would not be more than one-third of its total support for the 4-year period (\$450,000). Since A is a disqualified person, her bequest cannot be included in the numerator of the one-third support test under section 509(a)(2)(A). However, based on the factors set forth in subparagraph (4) of this paragraph, A's bequest may be excluded as an unusual grant under subparagraph (3) of this paragraph. Therefore, X will be considered to have met the support test for the taxable years 1974 and 1975.

**Example 3.** In 1970, Y, an organization described in section 501(c)(3), was created by A, the holder of all the common stock in M corporation, B, A's wife, and C, A's business associate. Each of the three creators made small cash contributions to Y to enable it to begin operations. The purpose of Y was to sponsor and equip athletic teams for underprivileged children in the community. Between 1970 and 1973, Y was able to raise small amounts of contributions through fund raising drives and selling admission to some of

the sponsored sporting events. For its first year of operations, it was determined that Y was excluded from the definition of *private foundation* under the provisions of section 509(a)(2). A made small contributions to Y from time to time. At all times, the operations of Y were carried out on a small scale, usually being restricted to the sponsorship of two to four baseball teams of underprivileged children. In 1974, M recapitalized and created a first and second class of 6 percent nonvoting preferred stock, most of which was held by A and B. A then contributed 49 percent of his common stock in M to Y. A, B, and C continued to be active participants in the affairs of Y from its creation through 1974. A's contribution of M's common stock was substantial and constituted 90 percent of Y's total support for 1974. Although Y could satisfy the one-third support test on the basis of the four taxable years prior to 1974, a combination of the facts and circumstances described in subparagraph (4) of this paragraph preclude A's contribution of M's common stock in 1974 from being excluded as an unusual grant under subparagraph (3) of this paragraph. A's contribution in 1974 constituted a substantial and material change in Y's sources of support within the meaning of subparagraph (1)(ii) of this paragraph and on the basis of the 5-year period prescribed in subparagraph (1)(ii) of this paragraph (1970 to 1974), Y would not be considered as *normally* meeting the one-third support test described in paragraph (a)(2) of this section for the taxable years 1974 (the current taxable year) and 1975 (the immediately succeeding taxable year).

**Example 4.** M, an organization described in section 501(c)(3), was organized in 1971 to promote the appreciation of ballet in a particular region of the United States. Its principal activities will consist of erecting a theater for the performance of ballet and the organization and operation of a ballet company. The governing body of M consists of 9 prominent unrelated citizens residing in the region who have either an expertise in ballet or a strong interest in encouraging appreciation of the art form. In order to provide sufficient capital for M to commence its activities, X, a private foundation, makes a grant of \$500,000 in cash to M. Although A, the creator of X, is one of the nine members of M's governing body, was one of M's original founders, and continues to lend his prestige to M's activities and fund raising efforts, A does not, directly or indirectly, exercise any control over M. By the close of its first taxable year, M has also received a significant amount of support from a number of smaller contributions and pledges from other members of the general public. Upon the opening of its first season of ballet performances, M expects to charge admission to the general public. Under the above circumstances, the

grant by X to M may be excluded as an unusual grant under subparagraph (3) of this paragraph for purposes of determining whether M meets the one-third support test under section 509(a)(2). Although A was a founder and member of the governing body of M, X's grant may be excluded.

*Example 5.* Assume the same facts as Example 4. In 1974, during M's third season of operations, B, a widow, passed away and bequeathed \$4 million to M. During 1971 through 1973, B had made small contributions to M, none exceeding \$10,000 in any year. During 1971 through 1974, M had received approximately \$550,000 from receipts for admissions and contributions from the general public. At the time of B's death, no person standing in a relationship to B described in section 4946(a)(1) (C) through (G) was a member of M's governing body. B's bequest was in the form of cash and readily marketable securities. The only condition placed upon the bequest was that it be used by M to advance the art of ballet. Under the above circumstances, the bequest of B to M may be excluded as an unusual grant under subparagraph (3) of this paragraph for purposes of determining whether M meets the one-third support test under section 509(a)(2).

*Example 6.* O is a research organization described in section 501(c)(3). O was created by A in 1971 for the purpose of carrying on economic studies primarily through persons receiving grants from O and engaging in the sale of economic publications. O's five-member governing body consists of A, A's sons, B, and C, and two unrelated economists. In 1971, A made a contribution to O of \$100,000 to help establish the organization. During 1971 through 1974 A made annual contributions to O averaging \$20,000 a year. During the same period, O received annual contributions from members of the general public averaging \$15,000 per year and receipts from the sale of its publications averaging \$50,000 per year. In 1974, B made an inter vivos contribution to O of \$600,000 in cash and readily marketable securities. Under a majority vote, the governing body decided to retain the Y stock for a period of at least 5 years. Under the above circumstances, A's contribution of the Y stock cannot be excluded as an unusual grant under subparagraph (3) of this paragraph for purposes of determining whether P meets the one-third support test.

(d) *Advance rulings to newly created organizations—(1) In general.* A ruling or determination letter that an organization is described in section 509(a)(2) will not be issued to a newly created organization prior to the close of its first taxable year consisting of at least 8 months. However, such organization may request a ruling or determination letter that it will be treated as a sec-

tion 509(a)(2) organization for its first 2 taxable years (or its first 3 taxable years, if its first taxable year consists of less than 8 months). For purposes of this section such 2- or 3-year period, whichever is applicable, shall be referred to as the advance ruling period. Such an advance ruling or determination letter may be issued if the organization can reasonably be expected to meet the requirements of paragraph (a) of this section during the advance ruling period. The issuance of a ruling or determination letter will be discretionary with the Commissioner.

(2) *Basic consideration.* In determining whether an organization *can reasonably be expected* (within the meaning of subparagraph (1) of this paragraph) to meet the one-third support test under section 509(a)(2)(A) and the not-more-than-one-third support test under section 509(a)(2)(B) described in paragraph (a) of this section for its advance ruling period or extended advance ruling period as provided in subparagraph (4) of this paragraph, if applicable, the basic consideration is whether its organizational structure, proposed programs or activities, and intended method of operation are such as to attract the type of broadly based support from the general public, public charities, and governmental units which is necessary to meet such tests. While the factors which are relevant to this determination, and the weight accorded to each of them, may differ from case to case, depending on the nature and functions of the organization, a favorable determination will not be made where the facts indicate that an organization is likely during its advance or extended advance ruling period to receive less than one-third of its support from permitted sources (subject to the limitations of paragraph (b) of this section) or to receive more than one-third of its support from items described in section 509(a)(2)(B).

(3) *Factors taken into account.* All pertinent facts and circumstances shall be taken into account under subparagraph (2) of this paragraph in determining whether the organizational structure, programs or activities, and method of operation of an organization are such as to enable it to meet the tests under



section 509(a)(2) for its advance or extended advance ruling period. Some of the pertinent factors are:

(i) Whether the organization has or will have a governing body which is comprised of public officials, or individuals chosen by public officials acting in their capacity as such, of persons having special knowledge in the particular field or discipline in which the organization is operating, of community leaders, such as elected officials, clergymen, and educators, or, in the case of a membership organization, of individuals elected pursuant to the organization's governing instrument or bylaws by a broadly based membership. This characteristic does not exist if the membership of the organization's governing body is such as to indicate that it represents the personal or private interests of disqualified persons, rather than the interests of the community or the general public.

(ii) Whether a substantial portion of the organization's initial funding is to be provided by the general public, by public charities, or by government grants, rather than by a limited number of grantors or contributors who are disqualified persons with respect to the organization. The fact that the organization plans to limit its activities to a particular community or region or to a special field which can be expected to appeal to a limited number of persons will be taken into consideration in determining whether those persons providing the initial support for the organization are representative of the general public. On the other hand, the subsequent sources of funding which the organization can reasonably expect to receive after it has become established and fully operational will also be taken into account.

(iii) Whether a substantial proportion of the organization's initial funds are placed, or will remain, in an endowment, and whether the investment of such funds is unlikely to result in more than one-third of its total support being received from items described in section 509(a)(2)(B).

(iv) In the case of an organization which carries on fund-raising activities, whether the organization has developed a concrete plan for solicitation of funds from the general public on a

community or area-wide basis; whether any steps have been taken to implement such plan; whether any firm commitments of financial or other support have been made to the organization by civic, religious, charitable, or similar groups within the community; and whether the organization has made any commitments to, or established any working relationships with, those organizations or classes of persons intended as the future recipients of its funds.

(v) In the case of an organization which carries on community services, such as slum clearance and employment opportunities, whether the organization has a concrete program to carry out its work in the community; whether any steps have been taken to implement that program; whether it will receive any part of its funds from a public charity or governmental agency to which it is in some way held accountable as a condition of the grant or contribution; and whether it has enlisted the sponsorship or support of other civic or community leaders involved in community service programs similar to those of the organization.

(vi) In the case of an organization which carries on educational or other exempt activities for, or on behalf of, members, whether the solicitation for dues-paying members is designed to enroll a substantial number of persons in the community, area, profession, or field of special interest (depending on the size of the area and the nature of the organization's activities); whether membership dues for individual (rather than institutional) members have been fixed at rates designed to make membership available to a broad cross-section of the public rather than to restrict membership to a limited number of persons; and whether the activities of the organization will be likely to appeal to persons having some broad common interest or purpose, such as educational activities in the case of alumni associations, musical activities in the case of symphony societies, or civic affairs in the case of parent-teacher associations.

(vii) In the case of an organization which provides goods, services, or facilities, whether the organization is or will be required to make its services, facilities, performances, or products

available (regardless of whether a fee is charged) to the general public, public charities, or governmental units, rather than to a limited number of persons or organizations; whether the organization will avoid executing contracts to perform services for a limited number of firms or governmental agencies or bureaus; and whether the service to be provided is one which can be expected to meet a special or general need among a substantial portion of the general public.

(4) *Extension of advance ruling period.*

(i) The advance ruling period described in subparagraph (1) of this paragraph shall be extended for a period of 3 taxable years after the close of the unextended advance ruling period if the organization so requests, but only if such organization's request accompanies its request for an advance ruling and is filed with a consent under section 6501(c)(4) to the effect that the period of limitation upon assessment under section 4940 for any taxable year within the extended advance ruling period shall not expire prior to 1 year after the date of the expiration of the time prescribed by law for the assessment of a deficiency for the last taxable year within the extended advance ruling period. An organization's extended advance ruling period is 5 taxable years if its first taxable year consists of at least 8 months, or is 6 taxable years if its first taxable year is less than 8 months.

(ii) Notwithstanding subdivision (i) of this subparagraph, an organization which has received or applied for an advance ruling prior to October 16, 1972, may file its request for the 3-year extension within 90 days from such date, but only if it files the consents required in this section.

(iii) See paragraph (e)(4)(i)(d) of this section for the effect upon the initial determination of status of an organization which receives an advance ruling for an extended advance ruling period.

(e) *Status of newly created organizations*—(1) *Advance or extended advance ruling.* This subparagraph shall apply to a newly created organization which has received a ruling or determination letter under paragraph (d) of this section that it be treated as a section 509(a)(2) organization for its advance or

extended advance ruling period. So long as such an organization's ruling or determination letter has not been terminated by the Commissioner before the expiration of the advance or extended advance ruling period, then whether or not such organization has satisfied the requirements of paragraph (a) of this section during such advance or extended advance ruling period, such an organization will be treated as an organization described in section 509(a)(2) in accordance with subparagraphs (2) and (3) of this paragraph, both for purposes of the organization and any grantor or contributor to such organization.

(2) *Reliance period.* Except as provided in subparagraphs (1) and (3) of this paragraph, an organization described in subparagraph (1) of this paragraph will be treated as an organization described in section 509(a)(2) for all purposes other than section 507(d) and 4940 for the period beginning with its inception and ending 90 days after its advance or extended advance ruling period. Such period will be extended until a final determination is made of such an organization's status only if the organization submits, within the 90-day period, information needed to determine whether it meets the requirements of paragraph (a) of this section for its advance or extended advance ruling period (even if such organization fails to meet the requirements of such paragraph (a)). However, since this subparagraph does not apply to section 4940, if it is subsequently determined that the organization was a private foundation from its inception, then the tax imposed by section 4940 shall be due without regard to the advance ruling or determination letter. Consequently, if any amount of tax under section 4940 in such a case is not paid on or before the last date prescribed for payment, the organization is liable for interest in accordance with section 6601. However, since any failure to pay such tax during the period referred to in this subparagraph is due to reasonable cause, the penalty under section 6651 with respect to the tax imposed by section 4940 shall not apply.

(3) *Grantors or contributors.* If a ruling or determination letter is terminated

by the Commissioner prior to the expiration of the period described in subparagraph (2) of this paragraph, for purposes of sections 170, 507, 545(b)(2), 556(b)(2), 642(c), 4942, 4945, 2055, 2106(a)(2), and 2522 the status of grants or contributions with respect to grantors or contributors to such organizations will not be affected until notice of change of status of such organization is made to the public (such as by publication of the Internal Revenue Bulletin). The preceding sentence shall not apply, however, if the grantor or contributor was responsible for, or aware of, the act or failure to act that resulted in the organization's loss of classification under section 509(a)(2) or acquired knowledge that the Internal Revenue Service had given notice to such organization that it would be deleted from such classification. See, however, § 1.509(a)-3(c)(5)(ii) for the procedures to be followed to protect the grantor or contributor from being considered responsible for, or aware of, the act or failure to act resulting in the grantee's loss of classification under section 509(a)(2).

(4) *Initial determination of status*— (i) *New organizations.* (a) The initial determination of status of a newly created organization is the first determination (other than by issuance of an advance ruling or determination letter under paragraph (d) of this section) that the organization will be considered as *normally* meeting the requirements of paragraph (a) of this section for a period beginning with its first taxable year.

(b) In the case of a new organization whose first taxable year is at least 8 months, except as provided for in subdivision (i)(d) of this subparagraph, the initial determination of status shall be based on a computation period of either the first taxable year or the first and second taxable years.

(c) In the case of a new organization whose first taxable year is less than 8 taxable months, except as provided for in subdivision (i)(d) of this subparagraph, the initial determination of status shall be based on a computation period of either the first and second taxable years or the first, second and third taxable years.

(d) In the case of an organization which has received a ruling or determination letter for an extended advance ruling period under paragraph (d)(4) of this section, the initial determination of status shall be based on a computation period of all of the taxable years in the extended advance ruling period. However, where the ruling or determination letter for an extended advance ruling period under paragraph (d)(4) of this section is terminated by the Commissioner prior to the expiration of the period described in subparagraph (2) of this paragraph, the initial determination of status shall be based on a computation period of the period provided for in (b) or (c) of this subdivision or, if greater, the number of years to which the advance ruling applies.

(e) An initial determination that an organization will be considered as *normally* meeting the requirements of paragraph (a) of this section shall be effective for each taxable year in the computation period plus (except as provided by paragraph (c)(1)(ii) of this section relating to material changes in sources of support) the two taxable years immediately succeeding the computation period. Therefore, in the case of an organization referred to in (b) of this subdivision to which paragraph (c)(1)(ii) of this section does not apply, with respect to its first, second, and third taxable years, such an organization shall be described in section 509(a)(2) if it meets the requirements of paragraph (a) of this section for either its first taxable year or for its first and second taxable years on an aggregate basis. In addition, if it meets the requirements of paragraph (a) of this section for its first and second taxable years it shall be described in section 509(a)(2) for its fourth taxable year. Once an organization is considered as *normally* meeting the requirements of paragraph (a) for a period specified under this subdivision, paragraph (c)(1)(i), (ii), or (iv) of this section shall apply.

(f) The provisions of this subdivision may be illustrated by the following examples:

*Example 1.* X, a calendar year organization described in section 501(c)(3), is created in February 1972 for the purpose of displaying African art. The support X received from the

public in 1972 satisfies the one-third support and not-more-than-one-third support tests described in section 509(a)(2) for its first taxable year, 1972. X may therefore get an initial determination that it meets the requirements of paragraph (a) of this section for its first taxable year beginning in February 1972 and ending on December 31, 1972. This determination will be effective for taxable years 1972, 1973, and 1974.

*Example 2.* Assume the same facts as in example 1 except that X also receives a substantial contribution from one individual in 1972 which is not excluded from the denominator of the one-third support fraction described in section 509(a)(2) by reason of the unusual grant provision of subparagraph (c)(3) of this section. Because of this substantial contribution, X fails to satisfy the one-third support test over its first taxable year, 1972. However, the support received from the public over X's first and second taxable years in the aggregate satisfies the one-third support and not-more-than-one-third support tests. X may therefore get an initial determination that it meets the requirements of paragraph (a) of this section for its first and second taxable years in the aggregate beginning in February 1972 and ending on December 31, 1973. This determination will be effective for taxable years 1972, 1973, 1974, and 1975.

*Example 3.* Y, a calendar year organization described in section 501(c)(3), is created in July 1972 for the encouragement of the musical arts. Y requests and receives an extended advance ruling period of five full taxable years plus its initial short taxable year of 6 months under subparagraph (d)(4) of this section. The extended advance ruling period begins in July 1972 and ends on December 31, 1977. The support received from the public over Y's first through sixth taxable years in the aggregate will satisfy the one-third support and not-more-than-one-third support tests described in section 509(a)(2). Therefore, Y in 1978 may get an initial determination that it meets the requirements of paragraph (a) of this section in the aggregate over all the taxable years in its extended advance ruling period beginning in July 1972 and ending on December 31, 1977. This determination will be effective for taxable years 1972 through 1979.

*Example 4.* Assume the same facts as in examples 3 except that the ruling for the extended advance ruling period is terminated prospectively at the end of 1975, so that Y may not rely upon such ruling for 1976 or any succeeding year. The support received from the public over Y's first through fourth taxable years (1972 through 1975) will not satisfy the one-third support and not-more-than-one-third support tests described in section 509(a)(2). Because the ruling was terminated, the computation period for Y's initial determination of status is the period 1972 through

1975. Since Y has not met the requirements of paragraph (a) of this section for such computation period, Y is not described in section 509(a)(2) for purposes of its initial determination of status. If Y is not described in section 509(a)(1), (3), or (4), then Y is a private foundation. As of 1976, Y shall be treated as a private foundation for all purposes (except as provided in subparagraph (3) of this paragraph with respect to grantors and contributors), and as of July 1972 for purposes of the tax imposed by section 4940 and for purposes of section 507(d) (relating to aggregate tax benefit).

(ii) *Advance rulings.* Unless a newly created organization has obtained a ruling or determination letter under paragraph (d) of this section that it be treated as a section 509(a)(2) organization for its advance or extended advance ruling period, it can not rely upon the possibility it will meet the requirements of paragraph (a) of this section for a taxable year which begins before the close of either applicable computation period provided for in subdivision (i) (b) or (c) of this subparagraph. Therefore, an organization which has not obtained such a ruling or determination letter, in order to avoid the risks associated with subsequently being determined to be a private foundation, may comply with the rules applicable to private foundations, and may pay, for example, the tax imposed by section 4940. In that event, if the organization subsequently meets the requirements of paragraph (a) for either applicable computation period, it shall be treated as a section 509(a)(2) organization from its inception, and, therefore, any tax imposed under chapter 42 shall be refunded and section 509(b) shall not apply.

(iii) *Penalties.* If a newly created organization fails to obtain a ruling or determination letter under paragraph (d) of this section, and fails to meet the requirements of paragraph (a) of this section for the first applicable computation period provided for in subdivision (i) (b) or (c) of this subparagraph, see section 6651 for penalty for failure to file return and pay tax.

(iv) *Examples.* This subparagraph may be illustrated by the following examples:

*Example 1.* On January 1, 1972, A contributes \$100,000 to X, an organization described in section 501(c)(3) which he created on such

date. X is not described in section 509(a) (1), (3), or (4). X's governing instrument does not contain the provisions referred to in section 508(e). Therefore, A is not entitled to a deduction under section 170 for the \$100,000 contribution by reason of section 508(d)(2)(A) unless X is described in section 509(a)(2). If X meets the requirements of section 509(a)(2) for 1972 and 1973 on an aggregate basis, then whether or not X met the requirements of section 509(a)(2) for 1972 based on the support received in 1972, X would not have to meet the governing instrument requirements of section 508(e), and section 508(d)(2)(A) would not prevent A from claiming the deduction under section 170 for 1972. If X fails to meet the requirements of section 509(a)(2) for both 1972 and, on an aggregate basis, 1972 and 1973, X would lose its exempt status under section 508(e) for both 1972 and 1973, and A would be barred by section 508(d)(2)(A) from claiming a deduction for the \$100,000 contribution to X.

*Example 2.* Assume the same facts as in example 1 except that X's governing instrument contains provisions which meet the requirements of section 508(e) in the event X is a private foundation, but do not apply to X in the event X is not a private foundation. Whether or not X meets the requirements of section 509(a)(2) for 1972 based on the support received in 1972 or 1972 and 1973 on an aggregate basis, since X meets the requirements of section 508(e), section 508(d)(2)(A) would not bar A from claiming a deduction under section 170 for 1972 for the contribution to X.

(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 grant-

or 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 con-

stitute *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 is 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).

(h) *Definition of membership fees*—(1) *General rule.* For purposes of section 509(a)(2), the fact that a membership organization provides services, admissions, facilities, or merchandise to its members as part of its overall activities will not, in itself, result in the classification of fees received from members as *gross receipts* rather than *membership fees*. If an organization uses membership fees as a means of selling admissions, merchandise, services, or the use of facilities to members of the general public who have no common goal or interest (other than the desire to purchase such admissions, merchandise, services, or use of facilities), then the income received from such fees shall not constitute *membership fees* under section 509(a)(2)(A)(i), but shall, if from a related activity, constitute *gross receipts* under section 509(a)(2)(A)(ii). On the other hand, to the extent the basic purpose for making the payment is to provide support for the organization rather than to purchase admissions, merchandise, services, or the use of facilities, the income received from such payment shall constitute *membership fees*.

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

*Example 1.* M is a symphony society described in section 501(c)(3). Its primary purpose is to support the local symphony orchestra. The organization has three classes of membership. Contributing members pay annual dues of \$10, sustaining members pay

\$25, and honorary members pay \$100. The dues are placed in a maintenance fund which is used to provide financial assistance in underwriting the orchestra's annual deficit. Members have the privilege of purchasing subscriptions to the concerts before they go on sale to the general public, but must pay the same price as any other member of the public. They also are entitled to attend a number of rehearsals each season without charge. Under these circumstances, M's receipts from the members constitute *membership fees* for purposes of section 509(a)(2)(A)(i).

*Example 2.* N is a theater association described in section 501(c)(3). Its purpose is to support a repertory company in the community in order to make live theatrical performances available to the public. The organization sponsors six plays each year. Members of the organization are entitled to a season subscription to the plays. The fee paid as dues approximates the retail price of the six plays, less a 10-percent discount. Tickets to each performance are also sold directly to the general public. The organization also holds a series of lectures on the theater which members may attend. Under these circumstances, the fees paid by members as dues will be considered *gross receipts* from a related activity. Although the fees are designated as membership fees, they are actually admissions to a series of plays.

(i) *Bureau defined*—(1) *In general.* The term *any bureau or similar agency of a governmental unit* (within the meaning of section 509(a)(2)(A)(ii)), refers to a specialized operating unit of the executive, judicial, or legislative branch of government where business is conducted under certain rules and regulations. Since the term *bureau* refers to a unit functioning at the operating, as distinct from the policymaking, level of government, it is normally descriptive of a subdivision of a department of government. The term *bureau*, for purposes of section 509(a)(2)(A)(ii), would therefore not usually include those levels of government which are basically policymaking or administrative, such as the office of the Secretary or Assistant Secretary of a department, but would consist of the highest operational level under such policymaking or administrative levels. Each subdivision of a larger unit within the Federal Government, which is headed by a Presidential appointee holding a position at or above Level V of the Executive Schedule under 5 U.S.C. 5316, will



normally be considered an administrative or policymaking, rather than an operating, unit. Amounts received from a unit functioning at the policymaking or administrative level of government will be treated as received from one bureau or similar agency of such unit. Units of a governmental agency above the operating level shall be aggregated and considered a separate bureau for this purpose. Thus, an organization receiving gross receipts from both a policymaking or administrative unit and an operational unit of a department will be treated as receiving gross receipts from two *bureaus* within the meaning of section 509(a)(2)(A)(ii). For purposes of this subparagraph, the Departments of Air Force, Army, and Navy are separate departments and each is considered as having its own policymaking, administrative, and operating units.

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

*Example 1.* The Bureau of Health Insurance is considered a *bureau* within the meaning of section 509(a)(2)(A)(ii). It is a part of the Department of Health, Education, and Welfare, whose Secretary performs a policymaking function, and is under the Social Security Administration, which is basically an administrative unit. The Bureau of Health Insurance is in the first operating level within the Social Security Administration. Similarly, the National Cancer Institute would be considered a *bureau*, as it is an operating part of the National Institutes of Health within the Department of Health, Education, and Welfare.

*Example 2.* The Bureau for Africa and the Bureau for Latin America are considered *bureaus* within the meaning of section 509(a)(2)(A)(ii). Both are separate operating units under the administrator of the Agency for International Development, a policymaking official. If an organization received gross receipts from both of these bureaus, the amount of gross receipts received from each would be subject to the greater of \$5,000 or 1 percent limitation under section 509(a)(2)(A)(ii).

*Example 3.* The Bureau of International Affairs of the Civil Aeronautics Board is considered a *bureau* within the meaning of section 509(a)(2)(A)(ii). It is an operating unit under the administrative office of the Executive Director. The subdivisions of the Bureau of International Affairs are Geographic Areas and Project Development Staff. If an organization received gross receipts from these subdivisions, the total gross receipts

from these subdivisions would be considered gross receipts from the same *bureau*, the Bureau of International Affairs, and would be subject to the greater of \$5,000 or 1 percent limitation under section 509(a)(2)(A)(ii).

*Example 4.* The Department of Mental Health, a State agency which is an operational part of State X's Department of Public Health, is considered a *bureau*. The Department of Public Health is basically an administrative agency and the Department of Mental Health is at the first operational level within it.

*Example 5.* The Aeronautical Systems Division of the Air Force Systems Command, and other units on the same level, are considered separate *bureaus* with the meaning of section 509(a)(2)(A)(ii). They are part of the Department of the Air Force which is a separate department for this purpose, as are the Army and Navy. The Secretary and the Under Secretary of the Air Force perform the policymaking function, the Chief of Staff and the Air Force Systems Command are basically administrative, having a comprehensive complement of staff functions to provide administration for the various divisions. The Aeronautical Systems Division and other units on the same level are thus the first operating level, as evidenced by the fact that they are the units that let contracts and perform the various operating functions.

*Example 6.* The Division of Space Nuclear Systems, the Division of Biology and Medicine, and other units on the same level within the Atomic Energy Commission are each separate *bureaus* within the meaning of section 509(a)(2)(A)(ii). The Commissioners (which make up the Commission) are the policymakers. The general manager and the various assistant general managers perform the administrative function. The various divisions perform the operating function as evidenced by the fact that each has separate programs to pursue and contracts specifically for these various programs.

(j) *Grants from public charities—(1) General rule.* For purposes of the one-third support test in section 509(a)(2)(A), grants (as defined in paragraph (g) of this section) received from an organization described in section 509(a)(1) (hereinafter referred to in this subparagraph as a *public charity*) are generally includible in full in computing the numerator of the recipient's support fraction of the taxable year in question. It is sometimes necessary to determine whether the recipient of a grant from a public charity has received such support from the public charity as a grant, or whether the recipient has in fact received such support as an indirect contribution from a

donor to the public charity. If the amount received is considered a grant from the public charity, it is fully includible in the numerator of the support fraction under section 509(a)(2)(A). However, if the amount received is considered to be an indirect contribution from one of the public charity's donors which has passed through the public charity to the recipient organization, such amount will retain its character as a contribution from such donor and, if, for example, the donor is a substantial contributor (as defined in section 507(d)(2)) with respect to the ultimate recipient, such amount shall be excluded from the numerator of the support fraction under section 509(a)(2). If a public charity makes both an indirect contribution from its donor and an additional grant to the ultimate recipient, the indirect contribution shall be treated as made first.

(2) *Indirect contributions.* For purposes of subparagraph (1) of this paragraph, an indirect contribution is one which is expressly or impliedly earmarked by the donor as being for, or for the benefit of, a particular recipient (rather than for a particular purpose).

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

*Example 1.* M, a national foundation for the encouragement of the musical arts, is an organization described in section 170(b)(1)(A)(vi). A gives M a donation of \$5,000 without imposing any restrictions or conditions upon the gift. M subsequently makes a \$5,000 grant to X, an organization devoted to giving public performances of chamber music. Since the grant to X is treated as being received from M, it is fully includible in the numerator of X's support fraction for the taxable year of receipt.

*Example 2.* Assume M is the same organization described in example 1. B gives M a donation of \$10,000, but requires that M spend the money for the purpose of supporting organizations devoted to the advancement of contemporary American music. M has complete discretion as to the organizations of the type described to which it will make a grant. M decides to make grants of \$5,000 each to Y and Z, both being organizations described in section 501(c)(3) and devoted to furthering contemporary American music. Since the grants to Y and Z are treated as being received from M, Y and Z may each include one of the \$5,000 grants in the numerator of its support fraction for purposes of section 509(a)(2)(A). Although the donation

to M was conditioned upon the use of the funds for a particular purpose, M was free to select the ultimate recipient.

*Example 3.* N is a national foundation for the encouragement of art and is an organization described in section 170(b)(1)(A)(vi). Grants to N are permitted to be earmarked for particular purposes. O, which is an art workshop devoted to training young artists and claiming status under section 509(a)(2), persuades C, a private foundation, to make a grant of \$25,000 to N. C is a disqualified person with respect to O. C made the grant to N with the understanding that N would be bound to make a grant to O in the sum of \$25,000, in addition to a matching grant of N's funds to O in the sum of \$25,000. Only the \$25,000 received directly from N is considered a grant from N. The other \$25,000 is deemed an indirect contribution from C to O and is to be excluded from the numerator of O's support fraction.

(k) *Method of accounting.* For purposes of section 509(a)(2), an organization's support will be determined solely on the cash receipts and disbursement method of accounting described in section 446(c)(1). For example, if a grantor makes a grant to an organization payable over a term of years, such grant will be includible in the support fraction of the grantee organization only when and to the extent amounts payable under the grant are received by the grantee.

(l) *Gross receipts from section 513(a) (1), (2), or (3) activities.* For purposes of section 509(a)(2)(A)(ii), gross receipts from activities described in section 513(a) (1), (2), or (3) will be considered gross receipts from activities which are not unrelated trade or business.

(m) *Gross receipts distinguished from gross investment income.* (1) For purposes of section 509(a)(2), where the charitable purpose of an organization described in section 501(c)(3) is accomplished through the furnishing of facilities for a rental fee or loans to a particular class of persons, such as aged, sick, or needy persons, the support received from such persons will be considered *gross receipts* (within the meaning of section 509(d)(2)) from an activity which is not an unrelated trade or business, rather than *gross investment income*. However, if such organization also furnishes facilities or loans to persons who are not members of such class

and such furnishing does not contribute importantly to the accomplishment of such organization's exempt purposes (aside from the need of such organization for income or funds or the use it makes of the profits derived), the support received from such furnishing will be considered *rents* or *interest* and therefore will be treated as *gross investment income* within the meaning of section 509(d)(4), unless such income is included in computing the tax imposed by section 511.

(2) The provisions of this paragraph may be illustrated by the following example:

*Example.* X, an organization described in section 501(c)(3), is organized and operated to provide living facilities for needy widows of deceased servicemen. X charges such widows a small rental fee for the use of such facilities. Since X is accomplishing its exempt purpose through the rental of such facilities, the support received from the widows is considered *gross receipts* within the meaning of section 509(d)(2). However, if X rents part of its facilities to persons having no relationship to X's exempt purpose, the support received from such rental will be considered *gross investment income* within the meaning of section 509(d)(4), unless such income is included in computing the tax imposed by section 511.

[T.D. 7212, 37 FR 21907, Oct. 17, 1972, as amended by T.D. 7784, 46 FR 37889, July 23, 1981; T.D. 8423, 57 FR 33443, July 29, 1992; T.D. 8991, 67 FR 20437, Apr. 25, 2002]

#### § 1.509(a)-4 Supporting organizations.

(a) *In general.* (1) Section 509(a)(3) excludes from the definition of *private foundation* those organizations which meet the requirements of subparagraphs (A), (B), and (C) thereof.

(2) Section 509(a)(3)(A) provides that a section 509(a)(3) organization must be organized, and at all times thereafter operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2). Section 509(a)(3)(A) describes the nature of the support or benefit which a section 509(a)(3) organization must provide to one or more section 509(a)(1) or (2) organizations. For purposes of section 509(a)(3)(A), paragraph (b) of this section generally describes the organizational and operational tests; paragraph (c) of this sec-

tion describes permissible purposes under the organizational test; paragraph (d) of this section describes the requirement of supporting or benefiting one or more *specified* publicly supported organizations; and paragraph (e) of this section describes permissible beneficiaries and activities under the operational test.

(3) Section 509(a)(3)(B) provides that a section 509(a)(3) organization must be operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or (2). Section 509(a)(3)(B) and paragraph (f) of this section describe the nature of the relationship which must exist between the section 509(a)(3) and section 509(a)(1) or (2) organizations. For purposes of section 509(a)(3)(B), paragraph (g) of this section defines *operated, supervised, or controlled by*; paragraph (h) of this section defines *supervised or controlled in connection with*; and paragraph (i) of this section defines *operated in connection with*.

(4) Section 509(a)(3)(C) provides that a section 509(a)(3) organization must not be controlled directly or indirectly by disqualified persons (other than foundation managers or organizations described in section 509(a)(1) or (2)). Section 509(a)(3)(C) and paragraph (j) of this section prescribe a limitation on the control over the section 509(a)(3) organization.

(5) For purposes of this section, the term *supporting organization* means either an organization described in section 509(a)(3) or an organization seeking section 509(a)(3) status, depending upon its context. For purposes of this section, the term *publicly supported organization* means an organization described in section 509(a)(1) or (2).

(b) *Organizational and operational tests.* (1) Under subparagraph (A) of section 509(a)(3), in order to qualify as a supporting organization, an organization must be both organized and operated exclusively *for the benefit of, to perform the functions of, or to carry out the purposes of* (hereinafter referred to in this section as being organized and operated *to support or benefit*) one or more specified publicly supported organizations. If an organization fails to meet either the organizational or the