

Designated Giving: Properly Handling Restricted Funds

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Churches receive charitable contributions every week. For the most part, donors make contributions to the church without designating how the funds should be spent. However, sometimes donors place stipulations or restrictions on their donations. These designated funds often cause confusion for church leaders and lead to several questions: Does the church have to accept the contribution? Does the church have to honor the designation? Can the funds be used for some other purpose?

Because of the nature of these gifts, churches may have trouble properly handling these designated offerings. And in certain circumstances, if a church mishandles designated funds, severe consequences can occur. Here are some important facts to consider when deciding what to record, report and do with designated funds.

TAX-DEDUCTIBLE CONTRIBUTIONS

According to the IRS, if a person wants to give a contribution to a church and get a tax deduction, the donor must relinquish control and allow the church to use the contribution however the church best decides.

But what if the donor designates the contribution for a particular person?

Consider what the IRS has stated:

If contributions to the fund are earmarked by the donor for a particular individual, they are treated, in effect, as being gifts to the designated individual and are not deductible. However, a deduction will be allowable where it is established that a gift is intended by a donor for the use of the organization and not as a gift to an individual. The test in each case is whether the organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes. IRS Revenue Ruling 62-113¹

In most cases, if an unsolicited contribution is designated for a specific person, the contribution doesn't qualify as a tax-deductible contribution. The donor isn't giving the church full control over how the contribution should be used.

Based on the IRS guidance a couple exceptions can be made:

- Designating a contribution to a church benevolence fund and merely "suggesting" a recipient could still qualify as a tax-deductible contribution.

Continued on next page...

Designated Giving: Properly Handling Restricted Funds (cont.)

- Designating a contribution to a visiting missionary could qualify as a tax-deductible contribution if the donation is sent to the missionary's missions agency who retains full control and discretion over the funds.

What if the donor designates the contribution for a specific project?

The IRS guidance stated above also suggests that if the church board or congregation approves a project, such as a building construction fund, any contribution designated for that project will qualify as a tax deductible contribution. The underlying premise is that the church retains control of the funds to use at their discretion.

As long as the project has been previously approved by the governing board, any donations will be tax deductible.

However, if a donor designated a contribution for a program or project that hasn't been approved by the governing board, the contribution may not qualify as a tax-deductible contribution.

HONORING DONOR DESIGNATIONS

Churches should honor designations as much as possible. Certainly, if the church has advertised a building program or solicited funds for a specific missions project, it is important to use these funds for their intended purpose. The church has an ethical obligation, and in many cases, a legal obligation.

According to Rich Hammar, Legal Counsel for the Assemblies of God, church board members may be held liable for using funds designated by donors for other purposes. He cautions: "Since designated gifts generally can be enforced by someone (even if not the donor), church board members may be legally responsible for diverting designated gifts to other purposes. As a result, it is essential for church leaders to consult with an attorney before using a donor's designated funds for some other purpose."²

In a few cases, courts have ruled that a donor has no legal standing to enforce a designated gift to a charity. In these cases, once the donor made the gift, the court determined the donor transferred control over to the charity. However, these few examples don't mean churches should ignore donor designations. Honoring designations will promote goodwill with donors and increase their confidence in how their donations are used. Further, it will minimize any legal risk to the church.

UNUSED CONTRIBUTIONS

What should church leaders do if a building program is cancelled, or a particular program has outlived its purposes? Can the church use remaining designated funds for other purposes?

Because of the risk and liability involved, church leaders should proceed carefully before using designated funds for other purposes.

Continued on next page...

Designated Giving: Properly Handling Restricted Funds (cont.)

If the church can identify the donors who contributed the designated funds, the church should request the donors' permission to use the funds for another purpose. To protect the church and avoid any misunderstanding, this decision should be communicated in writing. In some cases, the donor may want the contribution returned, which the church should honor.

If the church can't identify the donors (because donations were given anonymously, or records don't exist), the church leadership should have an official business meeting and let the members vote on how the funds should be used. The decision should be documented in the official board minutes.

PROTECTING THE CHURCH

There are a few steps a church should take to minimize risk for future restricted contributions. One step is to establish a written policy on how designated funds will be used. This policy should address the specific funds approved by the governing board and define how the funds will be used. The policy document should also address where excess funds will be used if the project is completed, or what will happen to designated funds if the project is cancelled.³

Further, the church may want to include in their policy (and publish in solicitation materials or on their website) that any funds received over and above the budget of the solicited purpose will be put in the general operating fund for other ministry purposes.

Lastly, keep restricted funds segregated. Most financial software today can accurately track and report on restricted and unrestricted funds. It is important to make sure restricted funds are not used for general operating expenses because of sloppy bookkeeping or inaccurate reporting. You may even want to keep the restricted funds in a separate bank account for additional protection. Too often I've seen designated funds commingled with general funds in one bank account and due to poor accounting practices, the available cash was used for operating expenses before leadership realized restricted funds were unintentionally used. Austerity measures were then needed to replenish the restricted funds.

Don't let this happen to your church. Follow these procedures and keep accurate records to ensure your church properly handles restricted funds.

Notes:

1. For the full text of the ruling, see <http://www.charitableplanning.com/document/667059>
2. Excerpted from Richard Hammar's article titled "Personal Liability of Board Members - Violation of Trust Terms," published at <http://www.churchlawandtax.com/private/boardmembers/lesson.php?75>
3. To view a working model of a designated fund policy, Lifeway.com has published a useful document at <http://www.lifeway.com/Article/pastor-church-administration-designated-contributions>.

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About the Author:

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