THE FOURSQUARE CHURCH

Restricted vs. Unrestricted Donations

What are restricted donations?

Financial Accounting Standard (FAS 116) defines a charitable donation as "a transfer of cash or other assets that is voluntary, non-reciprocal and unconditional." These three criteria ensure the tax deductibility of a contribution made toward a charitable or religious purpose.

However, there are often scenarios where donors want to contribute money toward a specific cause or project, thus creating a "condition" for their gift. In response, both the US tax code and the financial accounting standards have incorporated provisions under which donors may legally restrict or add conditions to their gift without compromising the tax deductibility of the gift. In short, these provisions require that:

- Donors cannot restrict their gift to the private benefit of an individual, and
- Church must exercise exclusive "discretionary control" over gifts

Donations that meet these criteria are called "donor-restricted funds" and are legally restricted to being used only for the specified purpose. These restrictions create a responsibility for churches to have a more sophisticated accounting system to ensure that the receipt, use and balance of restricted funds can be accurately reported on the church's financial statements, being used only for the specified purpose.

In contrast to general tithes and offerings used to support the church's regular operation, restricted donations are earmarked to a special "fund" set up by the church council. For example, a church council may decide to establish a building fund for the eventual purchase or construction of a building. The difference between the church's general fund and a restricted fund is that general fund gifts are unconditional, voluntary, and non-reciprocal since they are given without specific requirements on how the funds must be used.

What are the requirements for managing restricted funds?

Restricted fund balances must be accounted for separately from general fund balances. State and federal regulations forbid restricted funds from being spent on general operating purposes or earmarked to benefit a particular individual (i.e., restricting money specifically to help support a pastor's salary). The separation of these funds can be managed most accurately using accounting software.

Contrary to popular belief, a separate bank account is unnecessary to manage these restrictions.

Purposeful or unintentional misuse of funds or restrictions can cause one or more government agencies to audit the church. Therefore, it is important to keep the following principles in mind when establishing and managing restricted funds:

- The church council should authorize the fund with this decision clearly dated and documented in the council minutes. The decision to establish a fund for a specific purpose legally documents the church's exercise of "discretion" to engage in these activities.
- Restricted donations should only be accepted to projects or purposes for which the church council has established a fund. Donations made to purposes or projects for which a fund does not exist should be returned to the donor with an explanation that the church does not have a corresponding fund, allowing the donor to earmark their gift and maintain its tax deductibility.
- Churches should NEVER receive restricted donations to benefit a specific individual or family. See IRS Publication 526 (Links to an external site) for more information. information.