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Ad Revenue

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Yes, there is math involved

Nonprofit organizations are not limited to raising funds solely through charitable contributions or program service revenues. Similar to commercial entities, nonprofits may also generate revenue by selling advertising. These ads can appear on websites or within brochures or periodicals, and they generally result in taxable income reportable on the federal Form 990-T (the form used to report taxable income).

Gathering all components of net advertising income and accurately reporting this data might appear to be a straightforward exercise. In reality, accurately bifurcating, or separating, different expense types and calculating circulation income can be challenging.

Gross revenue is the only number used in the complete net advertising income calculation that is not reliant upon pro-rata (proportionate) allocations or preceding data manipulation. The other components -- direct costs, blended costs, indirect costs, advertising and circulation percentages -- all require math before they can be used within the calculation. Each is interdependent with a least one other data point. Let's start by examining expenses.

Advertising Percentage

Calculating an advertising percentage is essential for your financial reporting. The first step is collecting an accurate count of advertising pages sold and total number of pages in the publication or website (select a reasonable methodology to make comparable measurements of web pages and be consistent).

Using the ad pages as your numerator, divide by total pages to arrive at a percentage. For example, a publication with a total page count of 80 and 46 pages of advertising would divide 46/80 to arrive at an advertising percentage of 57%.

The advertising percentage is a crucial component for bifurcating expenses into the three required categories: direct, indirect, and blended costs.

Direct Costs: These are those incurred solely for ad placement. Typically, these include agency fees, commissions, and similar expenses. Note that direct costs do not include those incurred to publish editorial content, and this is an important distinction.

Indirect Costs: These are those incurred solely for editorial (non-advertising) content. Like direct costs, these should be tracked or separated out from all others and placed in a distinct bucket. Examples include staff salaries and benefits, among others.

Blended Costs: Also known as "periodical costs," blended costs are a mix of both direct and indirect costs. They include all of the costs incurred to place paid advertisements and produce the publication. Printing, postage, salaries, design, and overhead expenses are generally included in blended cost expenses.

Readership Costs: With all expenses properly allocated, the sum of the non-advertising periodical costs and the editorial costs become your readership costs. Readership costs may be deducted to reduce circulation income, but not gross income (separate revenue sources). Readership costs are only deductible up to the amount of total circulation income, if any.

Circulation Income

If subscribers pay a fee to receive the publication, circulation income must be calculated. Properly calculating circulation income is complex. In addition to advertising and/or subscription income (if any), circulation income must also be imputed (estimated) if nonprofit members receive access to the periodical as part of their membership dues.

In the absence of these revenues, there is no circulation income, and therefore neither indirect nor blended costs may be applied.

To begin the circulation income calculation, gather the following data:

• Membership dues;

• Total expenses (form 990, part 9, line 25, column a);

• Direct, blended and indirect costs (periodical expenses);

• Direct expenses from other advertising; and,

• Professional fundraising expenses.

For those familiar with Forms 990 and 990-T, total expenses from Form 990, Part 9, Line 25 (exempt purpose expenses) must be reduced by the unrelated business income direct expenses from advertising and professional fundraising expenses to arrive at exempt periodical expenses.

And now the real work begins.

Circulation Percentage

Periodical expenses must be divided by exempt purpose expenses (Form 990, Part 9, Line 25) to create a circulation percentage. For example, if total expenses reported on Form 990 are $86,000 and total periodical expenses are $20,000, divide $20,000 / $86,000 to arrive at 23.26% as the circulation percentage.

Circulation percentage is then multiplied against membership dues to arrive at the circulation income total.

Before circulation percentage can be multiplied against membership dues, however, membership dues must be reduced by lobbying expenses. Consideration should also be given to whether members have the legal right to receive the publication as a part of their membership dues payment (along with other technical IRS requirements).

Documentation

Once the needed components to arrive at net advertising income are accumulated, taxpayers should document their methodologies and data for future use and reference. These resources are then readily available for continuous use and allow for better preparation to adequately support any taken positions should the entity be selected by the Internal Revenue Service for examination.

Grinding through this tedious calculation can unravel even the most prudent of recordkeepers. Advertising income is intricate, with many steps required to arrive at properly allocated expenses, circulation income, and readership costs. Each component requires accurate data collection and careful consideration of expense and revenue types, as well as exempt and taxable activities.

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