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## New Regulations on Type III Supporting Organizations Flesh Out Complex Requirements

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*Final, Temporary, and Proposed Regulations illuminate the different rules for "functionally integrated" and "non-functionally integrated" supporting organizations. The multiple standards include the responsiveness test, the integral part tests, and an annual minimum distribution requirement.*

Late last year Treasury and the IRS issued revised final and Temporary<sup>1</sup> Regulations (TD 9605, 12/28/12) regarding tax-exempt Section 501(c)(3) "Type III" supporting organizations that escape private foundation classification by virtue of Section 509(a)(3)(B)(iii).

The significance of understanding and complying with the changed rules for Type III supporting organizations cannot be overstated. There are no "intermediate sanctions" for noncompliance. If the rules are not followed, the organization will lose its Type III supporting organization status and become subject to the private foundation rules discussed below.<sup>2</sup>

### PRIVATE vs. PUBLIC

TRA '69 divided Section 501(c)(3) organizations into two categories: "private foundations" and "public charities." Supporting organizations described in Section 509(a)(3) are classified as public charities that are not private foundations.

Although subject to all the normal Section 501(c)(3) rules (such as requirements to stay out of political campaigns and operate exclusively for charitable purposes without inurement of net earnings to the benefit of private individuals), an organization treated as a public charity by virtue of being a supporting organization was able to avoid more restrictive private foundation rules such as:

- A 2% (now sometimes 1%) tax on net investment income including capital gains on donor-basis contributions and sales of property.<sup>3</sup>
- Absolute prohibition of certain "self-dealing" transactions with "disqualified persons" such as substantial contributors, trustees, directors, foundation managers and members of their families and entities in which they have a requisite interest.<sup>4</sup>
- An annual minimum (currently 5% of asset value) distribution requirement.<sup>5</sup>
- Prohibition of "excess business holdings."<sup>6</sup>
- Penalties (which in some instances may be in addition to or in lieu of loss of exempt status) with respect to certain grants and activities that require "expenditure responsibility" procedures or are not charitable in nature.<sup>7</sup>

A supporting organization also qualifies as a recipient of contributions under the more generous income tax rules applicable to gifts to

a public charity.<sup>8</sup>

A supporting organization must be organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified public charities<sup>9</sup> described in Sections 509(a)(1)<sup>10</sup> or 509(a)(2).<sup>11</sup> A supporting organization may not be controlled directly or indirectly by one or more "disqualified persons" other than officers, directors, trustees, or other employees with decision-making authority (known as "foundation managers") and one or more "public charities."<sup>12</sup>

Supporting organizations are divided into three "types":

- (1) Type I is "operated, supervised or controlled by" one or more supported organizations that are described in Sections 509(a)(1) or 509(a)(2).<sup>13</sup>
- (2) Type II is "supervised or controlled in connection with" one or more such supported organizations.<sup>14</sup>
- (3) Type III is "operated in connection with" one or more such supported organizations.<sup>15</sup>

## Type III Rules Prior to the PPA and 2012 Regulations

The classic "operated in connection with" Type III supporting organization is a trust established by a settlor with a bank or other unrelated trustee or perhaps multiple trustees, a majority of whom are unrelated to the settlor. Supporting organizations also may be incorporated, however, with a board of directors controlled by persons unrelated to those who have made substantial contributions thereto. According to the Preamble to TD 9605, based on 2009 data, there were 7,556 self-identified Type III supporting organizations (out of 1,238,201 recognized Section 501(c)(3) nonprofit organizations).

The operative rule has been and remains that a Type III supporting organization, among other things, must meet both a "responsiveness" test and an "integral part" test in order to avoid being classified as a private foundation.

**Responsiveness test.** Under the rules in effect prior to the Pension Protection Act of 2006 (PPA) and TD 9605, the responsiveness test could be met if:

- (1) (a) One or more of the supported organization's officers, directors or trustees are elected or appointed by the officers, directors, trustees, or membership of the supported organization, (b) one or more members of the governing bodies of the supported organization are also officers, directors, or trustees of, or hold other important offices in, the supporting organization, or (c) the officers, directors, or trustees of the supporting organization maintain a close, continuous working relationship with the officers, directors, or trustees of the supported organization; and
- (2) By reason of such arrangement, the officers, directors, or trustees of the supported organization have a "significant voice" in the investment policies of the supporting organization, the timing and manner of making grants, the selection of the grant recipients by the supporting organization, and otherwise directing the use of the income or assets of the supporting organization.

The Preamble to TD 9605 makes it clear that the responsiveness test requires only that the officers, directors, or trustees of a supported organization have the ability to influence the supporting organization's decisions regarding the supporting organization's use of its income or assets—not that the officers, directors, or trustees of the supported organization have control over such decisions.<sup>16</sup> In addition, Treasury and the IRS are still considering the best approach for applying the responsiveness test when the supporting organization's trust document specifies the recipients, timing, manner, and amount of grants.<sup>17</sup>

In addition, if an organization was a supporting organization before 11/20/70, additional facts and circumstances, such as a historic and continuing relationship, could be taken into account in addition to the foregoing factors.<sup>18</sup> Also, prior to the PPA, a charitable trust could meet a special responsiveness test if it was a charitable trust under state law, the supported organization was named in the charitable trust's governing instrument, and the supported organization had the power under state law to enforce the trust and compel an accounting.

**Integral part test.** Under the rules in effect prior to the PPA and TD 9605, the integral part test could be met through either a "but for" or "attentiveness" test.

The but for test was satisfied if the activities engaged in by the supporting organization for or on behalf of the supported organization normally would be engaged in by the supported organization itself but for the fact that the supporting organization is engaged in the activities.

The attentiveness test was satisfied if the supporting organization (1) made payment of "substantially all its income" (85% of adjusted net income including short-term capital gains)<sup>19</sup> to or for the use of the supported organization; (2) provided enough support to ensure the attentiveness of the supported organization; and (3) (in the event there was more than one supported organization) a substantial amount of the total support paid was to supported organizations that met the attentiveness requirement.

A special integral part test described in detail below existed (and continues to exist) for certain charitable trusts that were created prior to 11/20/70 and are required to distribute all their trust income to one or more supported organizations.

In summary, a Section 501(c)(3) organization could be classified as a Type III supporting organization if it met both a responsiveness test and either the but for or attentiveness requirements of an integral part test. Charitable trusts had an alternate responsiveness test, however, and certain grandfathered trusts automatically met an alternative integral part test.

## **Pension Protection Act of 2006**

Spurred on by sometimes dramatic reports of isolated abuse by persons creating or involved in Type III supporting organizations, a Congress led by Senator Charles Grassley (R-Iowa) and his staff chose not to rely on a variety of enforcement tools available to the IRS but instead to legislate significant revisions to the rules applying to supporting organizations,<sup>20</sup> including significant revisions to the rules for qualifying as a Type III "operated in connection with" supporting organization. These revised rules were tacked on to the PPA.

The PPA made five significant changes to the requirements an organization must meet to qualify as a Type III supporting organization:

- (1) It removed the alternative "responsiveness" test for charitable trusts.
- (2) It required Treasury to set a new payout requirement for organizations that are not "functionally" integrated (generally organizations that met the "integral part" test by satisfying the "attentiveness" test).
- (3) It provided that a Type III supporting organization must annually provide to each of its supported organizations information to ensure that the supporting organization is responsive to the needs of its supported organization(s).
- (4) It prohibited a Type III supporting organization from supporting any supported organization not organized in the U.S.
- (5) It prohibited a Type I or Type III supporting organization from accepting a gift or contribution from a person who, together with certain related persons, directly or indirectly, controls the governing body of a supported organization of the Type I or Type III supporting organization.

Although the PPA mandated certain changes, the legislation delegated much to Treasury and the IRS to figure out. Since the PPA, there have been a series of IRS announcements and Proposed Regulations,<sup>21</sup> culminating in the most recent pronouncement.

## **IMPACT OF THE 2012 REGULATIONS**

The 2012 final and Temporary Regulations attempt to implement the changes mandated and delegated by the PPA, and in the process make significant changes to the rules governing qualification for Type III supporting organization status.

### **‘Special’ Responsiveness Test Eliminated**

The responsiveness rule discussed above was essentially left unchanged *except* that the special responsiveness rule for charitable trusts was eliminated. This means that charitable trusts now must meet the "significant voice" responsiveness test generally applicable to all Type III supporting organizations.

An exception to the application of this test, and no other test, is provided in the case of a supporting organization that was supporting or benefiting a supported organization before 11/20/70. In that situation, additional facts and circumstances, such as a historic and continuing relationship between the organizations, may be taken into account.<sup>22</sup>

The 2012 final Regulations contain both a "good" and "bad" example of responsiveness or lack thereof.<sup>23</sup> Although the examples deal with trusts, there is no reason to think they would not also be explanatory in situations involving Type III supporting organizations that are not trusts.

Example 1 (the "good" example) posits a bank discretionary trustee of a testamentary trust supporting a private university. "Representatives" of the bank and an officer of the university have quarterly face-to-face or telephonic meetings<sup>24</sup> during which they discuss projected needs and ways in which the university would like the bank to use the trust's income and invest its assets.<sup>25</sup> The bank also communicates regularly with the university officer regarding the trust's investments and plans for distributions and then provides to the university officer quarterly investment statements, the notification requirements of the 2012 final Regulations (discussed below), and an annual accounting statement.

In Example 2 (the "bad" example), the bank trustee of a trust supporting three supported organizations sends annual cash payments, the notification required by the 2012 final Regulations, and an accounting statement.

Although IRS spokespersons consistently insist that these are just "examples," it should be apparent that sending money along with an annual accounting statement and the annual IRS notification requirements does not constitute a "significant voice" by the benefited organization(s) in the "investment policies of the supporting organization, the timing of grants, the manner of making grants, and the selection of grant recipients by such supporting organization, and in otherwise directing the use of the income or assets of the supporting organization."<sup>26</sup>

The Preamble to TD 9605 states that "The Treasury Department and the IRS intend to issue proposed regulations in the near future that amend the responsiveness test by clarifying that Type III supporting organizations must be responsive to all of their supported organizations."<sup>27</sup>

## Integral Part Test

The integral part test still must be met by all Type III supporting organizations. Under the final Regulations, however, the integral part test applies differently to functionally integrated and non-functionally integrated Type III supporting organizations.

The distinction between functionally integrated and non-functionally integrated Type III supporting organizations also is important to grantmaking private foundations. Grants to non-functionally integrated Type III supporting organizations are not treated as "qualifying distributions" for purposes of the private foundation minimum distribution requirements<sup>28</sup> and require "expenditure responsibility" procedures.<sup>29</sup>

The Preamble to the 2009 Proposed Regulations permitted private foundations to continue to rely on the criteria in Notice 2006-109, 2006-2 CB 1121, with respect to functionally integrated status.<sup>30</sup> Instead of allowing private foundations to rely on that criteria until determination letters addressing functionally related status were issued, the Preamble to the 2009 Proposed Regulations allowed reliance only until the Proposed Regulations were published as 2012 final or Temporary Regulations. Since the 2012 final and Temporary Regulations have now been issued, the new criteria are presumably the benchmark in the absence of a determination letter.<sup>31</sup>

**Functionally integrated Type IIIs.** There are three types of Type III supporting organizations that meet the "integral part" test because they are considered functionally integrated.<sup>32</sup>

*Substantially all activities.* The first type of functionally integrated Type III supporting organization is one that engages in activities "substantially all" (based on all pertinent facts and circumstances) of which (1) "directly further" the exempt purposes of one or more supported organizations ("direct furtherance" activities) to which the supporting organization is responsive (as discussed above) by performing the functions of or carrying out the purposes of the supported organization and (2) but for the involvement of the supporting organization would normally be engaged in by the supported organization.<sup>33</sup>

The activities must be conducted by the supporting organization itself, rather than by a supported organization. Holding title to or managing exempt-use assets counts as directly furthering the exempt purposes of a supported organization,<sup>34</sup> but fundraising, making grants (whether to the supported organization or to third parties), and investing and managing non-exempt-use assets (such as investments) do not.<sup>35</sup>

Making or awarding grants, scholarships, or other payments to individual beneficiaries who are members of the charitable class benefited by the supported organization count as direct activities, but only if (1) the recipients are chosen on an objective and nondiscriminatory basis as described in the private foundation rules,<sup>36</sup> (2) the officers, directors, or trustees of the supported organization have a significant voice in the timing of the payments, the manner of making them, and the selection of recipients, and (3)

the making or awarding of such payments is part of an active program of the supporting organization that directly furthers the exempt purposes of the supported organization and in which the supporting organization maintains significant involvement of the type required in the case of a private "operating" foundation.<sup>37</sup>

*Parent organization.* The second type of functionally integrated Type III supporting organization is one that is the parent of one or more supported organizations if the supporting organization exercises a substantial degree of direction over the policies, programs, and activities of the supported organization. In addition, a majority of the officers, directors, or trustees of the supported organization is appointed, directly or indirectly, by the governing body, members of the governing body, or officers (acting in their official capacity) of the supporting organization.<sup>38</sup> An example would be a healthcare system parent that appoints all board members of each hospital and outpatient clinic in the system.<sup>39</sup>

*Government entity.* The third type of functionally integrated Type III supporting organization is one that supports a government entity. The 2009 Proposed Regulations provided that a Type III supporting organization that supports one (and only one) supported organization "whose assets are subject to the appropriations process" of a federal, state, local, or Indian tribal government may treat grantmaking to the supported organization and managing non-exempt use assets on behalf of the supported organization as "direct furtherance" activities, as long as a substantial part of the supporting organization's total activities are otherwise direct furtherance activities.

There were several objections and comments to this limited approach, and the 2012 final Regulations reserve the subject with a comment in the Preamble that Proposed Regulations will be issued in the near future (but prior to the second tax year after 12/28/12 of affected organizations, during which time an affected organization can rely on the but for test under the old Regulations).<sup>40</sup>

**Non-functionally integrated Type IIIs.** If an organization does not qualify as functionally integrated, it must meet a separate integral part test to qualify as a non-functionally integrated Type III supporting organization. This requires meeting (1) both (a) a minimum payout requirement<sup>41</sup> and (b) an attentiveness requirement,<sup>42</sup> or (2) an alternative test for a trust that existed prior to 11/20/70.<sup>43</sup>

The required annual minimum distribution requirement proposed in the 2012 Temporary Regulations for non-functionally integrated supporting organizations is generally the greater of adjusted net income (as determined by reference to Section 4942(f)) or 3.5% of the average net value of investment assets (called the "minimum asset amount") determined for the immediately preceding tax year<sup>44</sup> as determined by applying the principles applicable to private foundations under Section 4942.<sup>45</sup> Distributions in excess of the annual distribution amount may be carried over for five subsequent years with the distributable amount in that later year first reduced by any excess amount carried over (with the oldest excess amount applied first).<sup>46</sup>

Distributions that may be counted are determined solely on the cash method and include amounts paid to a supported organization,<sup>47</sup> net amounts paid to perform a direct activity, reasonable and necessary administrative expenses of the supported organization other than investment-related expenses, and costs of exempt-use assets.<sup>48</sup> Unlike private foundations, the Regulations do not specifically state that administrative expenses of the supporting organizations will count toward the distribution requirement. The author of the Regulations has publicly stated, however, that further clarification should be forthcoming regarding what administrative expenses will and will not be counted toward the distribution requirement.

Set-asides are permitted under rules similar to those applying to private foundations under Section 4942(g)(2)(B)(i) (receipt of advance IRS approval, five-year limit, perjury statement from supported organization that this is better than immediate payment of funds) but not under Section 4942(g)(2)(B)(ii) (cash distribution test).<sup>49</sup> Distributions to donor-advised funds are disregarded.<sup>50</sup>

The 2012 final and Temporary Regulations do not deal with the status of program-related investments, but Treasury and the IRS "intend to provide further clarification in future proposed regulations."<sup>51</sup>

*Minimum payout.* The minimum distribution requirement will be applicable with respect to the second tax year after 12/28/12 (2014 for calendar-year reporting organizations) based on the value of investments during the first such tax year (2013 for calendar-year reporting organizations).<sup>52</sup> Nevertheless, a minimum amount still should be calculated for the first tax year following 12/28/12 (2013 for calendar-year reporting organizations) because an "excess distribution" for that year (for which the minimum distribution rule does *not* apply) may be carried forward in the following year (in which the minimum distribution rule does apply).<sup>53</sup>

*Attentiveness.* At least one-third of this distributable amount must be distributed to one or more "attentive" (a new standard) supported organizations to which the supporting organization is "responsive" (under the "responsiveness" general rule discussed above).<sup>54</sup>

"Attentiveness" is demonstrated during a tax year if, in that year:

- (1) The support is 10% or more of the supported organization's total support (or, in the case of a particular department or school of a university, hospital, or church, the total support of the department or school) received during the supported organization's last tax year ending before the beginning of the supporting organization's tax year;
- (2) The amount of support is necessary to avoid the interruption of a particular function or activity of the supported organization (the support is necessary if the supporting organization or the supported organization earmarks the support for a particular program or activity of the supported organization, as long as such program or activity is at least a substantial one); or
- (3) Sufficient attention is demonstrated by "all pertinent factors" including the amount of support and evidence of actual attentiveness.<sup>55</sup>

It is not clear to the authors how the attentiveness requirement dovetails with excess carryover distributions when, to take an extreme case, a large distribution to an attentive distributee minimizes later required distributions to levels that are not substantial enough to meet the attentiveness requirement. One presumes that if the attentiveness test is met in the year of the substantial carryover distribution, the attentiveness character of this distribution will carry over as well, but the 2012 final and Temporary Regulations do not address the issue.

## The Notification Requirement

All Type III supporting organizations, without regard to their status as functionally or non-functionally integrated, must satisfy an annual notification requirement.<sup>56</sup>

A Type III supporting organization must provide the following to *each* of its supported organizations:

- (1) A written notice addressed to a principal officer of the supported organization describing the type and amount of all of the support the supporting organization provided to the supported organization during the supporting organization's immediately preceding tax year as well as any other tax year of the supporting organization ending after 12/28/12 for which such support information has not been received;
- (2) A copy of the supporting organization's "most recently filed" Form 990 (redaction of the name and address of any contributor is permitted) and any other Form 990 for any other tax year of the supporting organization ending after 12/28/12 that has not been previously provided; and
- (3) A copy of the supporting organization's governing documents, unless such documents have been previously provided and not subsequently amended. These documents may be provided by electronic media.

The due date (postmark or date of electronic transmission) for submission of these documents is the last day of the fifth month following the close of the tax year (May 31 for calendar tax years). This is admittedly awkward for an organization that does not submit its Form 990 by May 15 (the due date for a calendar-year reporting organization) because the Form 990 is on extension or inadvertently not timely filed. That is why the 2012 final Regulations refer to the "most recently filed" Form 990. If the return has not been filed by May 31, the Form 990 filed for the year preceding the immediately preceding year may be transmitted.

The important point is that *notice must be given by the last day of the fifth month after the supporting organization's tax year without regard to the fact that the Form 990 for that year may not have yet been filed*. The only exception to that rule is that the notification date for supporting organizations in existence on 12/28/12 is the later of the last day of the fifth calendar month following the close of the supporting organization's tax year (May 31 for calendar-year reporting organizations) or the due date for the Form 990 for tax year 2012 with extensions.<sup>57</sup>

## Support of Non-U.S. Organization

An organization may not qualify as a Type III supporting organization if it supports any supported organization organized outside the U.S.<sup>58</sup> This provision (enacted by the PPA) applies particularly to many U.S.-organized "friends" groups that will now have to avoid private foundation status by meeting the "public support" tests of Section 170(b)(1)(A)(vi) or 509(a)(2).

## Gifts From Persons With Direct or Indirect Control

The 2012 final Regulations implement the PPA requirement that prohibits a Type I ("operated, supervised or controlled by" one or more supported public charities) or Type III ("operated in connection with" one or more supported public charities) supporting organization from accepting a gift or contribution from a person who, alone or together with certain related persons described below, directly or indirectly controls the governing body of a supported organization, or from such related persons possessing such control.<sup>59</sup> Such a supporting organization, however, may accept a gift or contribution from a public charity described in Sections 509(a)(1) or 509(a)(2) or a public safety testing organization described in Section 509(a)(4).<sup>60</sup>

For these purposes, related persons include family members and 35% controlled entities within the meaning of Section 4958(f).<sup>61</sup>

The 2012 final Regulations reserve the definition of "control." Treasury and the IRS have said they "intend to issue proposed regulations in the near future that will provide such a definition."<sup>62</sup>

## Excess Business Holdings

The 2012 final Regulations confirm that (1) the holdings of a Type III supporting organization immediately before 8/17/06 that was reclassified as a private foundation on or after that date solely because of PPA section 1241 will be determined using the same transitional disposition rules that apply to Type III supporting organizations under Section 4943(f)(7),<sup>63</sup> and (2) a trust that qualifies as a Type III supporting organization and meets the requirements of Reg. 1.509(a)-4(i)(9) will be treated as a "functionally integrated Type III supporting organization" for purposes of Section 4943(f)(3)(A).<sup>64</sup>

## CONCLUSION

The PPA and the resulting Regulations have complicated the rules for qualifying as a Type III supporting organization. Understanding and complying with these rules are critical to the continued qualification of such organizations as public charities. It is hoped that Treasury and the IRS will continue to refine and clarify the existing law and Regulations.

The changes made by the PPA were meant, at least in part, to eliminate abuses involving supporting organizations. There are a large number of valid supporting organizations across the U.S. that provide tremendous support for valuable charitable activities. Interpretation and enforcement of these rules should not hinder the charitable missions of such legitimate organizations.

## Practice Notes

Review of existing practices and procedures by Type III supporting organizations subject to the new final and Temporary Regulations is essential. The extensive and complex requirements, including minimum distribution rules and a notice requirement, will have to be complied with if supporting organizations are to avoid characterization under the much more restrictive private foundation rules.

<sup>1</sup> The Temporary Regulations, which deal with minimum distribution requirements, were also issued as Proposed Regulations (REG-155929-06, 12/28/12).

<sup>2</sup> See the Preamble to TD 9605, "Explanation of Provisions and Summary of Comments," part 7. Once an entity is classified as a private foundation, the Section 507 rules regarding termination of private foundation status apply if, for instance, the organization attempts to regain supporting organization classification by following the rules in the future. The 2012 final Regulations contain transitional rules, particularly with respect to minimum distribution requirements, that may be applicable if a Type III supporting organization is reclassified as a private foundation.

<sup>3</sup> Section 4940.

<sup>4</sup> Section 4941. Private foundation "self-dealing" transactions are not entirely prohibited, however. Persons classified under the Section 4958(c)(3)(A) definition (added by Pension Protection Act of 2006 (PPA)) as "disqualified persons" of a supporting organization (which is different from the definition of "disqualified persons" under Section 4946(a) applicable to private foundations subject to Section 4941)

are subject to the "intermediate sanctions" of Section 4958 penalizing any "excess benefit" transaction with a Section 501(c)(3) organization that is not at arm's-length fair value. In addition, Section 4958(c)(3)(A)(i)(I) treats as an automatic excess benefit transaction any "grant, loan, compensation, or other similar payment" made by a supporting organization to a "substantial contributor" (under Section 4958(c)(3)(C)(i), generally someone who contributes at least \$5,000 and more than 2% of total contributions and bequests received) or any related person with respect to a substantial contributor, and Section 4958(c)(3)(A)(i)(II) treats as an automatic excess benefit transaction any loan made by a supporting organization to any "disqualified person" as defined in Section 4958(f)(1) (other than a public charity which is not itself a supporting organization) whether or not such person is a substantial contributor.

<sup>5</sup>

Section 4942. Nevertheless, Type III supporting organizations that are trusts may have income distribution requirements under their governing instruments and the 2012 Temporary Regulations (also published as Proposed Regulations and subject to reconsideration) impose on Type III "non-functionally" integrated supporting organizations a minimum distribution requirement of the greater of 85% of adjusted net income or 3.5% of asset value.

<sup>6</sup>

Section 4943. The "excess business" holdings rules are now applicable to Type III "non-functionally" integrated supporting organizations. A "business holding" generally exceeds permitted limits if the aggregate holdings of an organization subject to the limits and all its "disqualified persons" (substantial contributors, trustees, directors, foundation managers and members of their families and entities in which they have requisite interests) exceed 20% of the voting or certain proprietary interests. The 20% is modified to 35% in the event others hold control and there is a 2% de minimis exception.

<sup>7</sup>

Section 4945.

<sup>8</sup>

See Section 170. Generally speaking, an individual's gift of cash to an organization that is treated as a public charity can be deducted up to 50% of AGI and a gift of long-term appreciated property such as stock or real estate can be deducted at FMV up to 30% of AGI (but a gift of tangible personal property qualifies for full value deduction only if it will be used in furthering the exempt purposes of the recipient organization). A gift of cash to an organization that is not treated as a public charity (for instance, a private grant-making foundation) can be deducted up to 30% of AGI and a gift of certain long-term appreciated stock can be deducted up to 20% of AGI (a gift of other property may be deducted as cash but only at an amount equal to the lesser of tax basis or FMV). Gifts in excess of the AGI limits may be carried over to up to five later tax years. Bequests of cash or any kind of property may be deducted for estate tax purposes without limit. Private "operating" foundations described in Section 4942(g) are treated as public charities for purposes of the income tax rules and limits.

<sup>9</sup>

Public charities are referred to as "publicly supported organizations" throughout the former and 2012 final Regulations, but the 2012 final Regulations amended Regs. 1.509(a)-4(a)(6) and 1.509(a)-4(i) to use "supported organization(s)" when referring to the specific publicly supported organization(s) a Type III supporting organization is "operated in connection with."

<sup>10</sup>

A public charity described in Section 509(a)(1) and the accompanying Regulations is one that is not a "private foundation" because it is a church, hospital, school, or government unit, or receives requisite support from contributions and bequests from the general public.

<sup>11</sup>

A public charity described in Section 509(a)(2) is one that is not a "private foundation" because it receives requisite support from membership fees, contributions, and bequests and/or activities that are substantially related to its exempt purpose and does not receive more than one-third of its support from investment income.

<sup>12</sup>

Section 509(a)(3)(C). The term "disqualified persons" is defined for this purpose in Section 4946(a) and includes substantial contributors, members of their families and related entities, as well as officers, directors, trustees, and other foundation managers.

<sup>13</sup>

Section 509(a)(3)(B)(i).

<sup>14</sup>

Section 509(a)(3)(B)(ii).

<sup>15</sup>

Section 509(a)(3)(B)(iii).

<sup>16</sup>

Preamble to TD 9605, *supra* note 2, part 4.

<sup>17</sup>

*Id.*

<sup>18</sup>

The trust need not necessarily make the distributions of all trust income on an annual basis but may accumulate income for future distribution in appropriate cases. GCM 36523 (12/18/75) held that an accumulation up to five years met the "all pertinent factors" test in the case of a trust that made grants to a zoo for animal acquisition and housing. See IRS EO Technical Instruction Program for FY 2003, "Public Charity or Private Foundation Status Issues under IRC 509(a)(1)-(4), 4942(j)(3), and 507," by Virginia G. Richardson and John Francis Reilly.

<sup>19</sup>

Rev. Rul. 76-208, 1976-1 CB 161.

<sup>20</sup>

As well as donor-advised funds, a topic beyond the scope of this article. See generally Lehmann, "Major Changes for Exempt Organizations in the Pension Protection Act of 2006," 106 JTAX 30 (January 2007), and Hester, "Donor-Advised Funds: When Are They the Best Choice for Charitably Minded Clients?," 108 JTAX 330 (June 2008).

<sup>21</sup>

Notice 2006-109, 2006-2 CB 1121, provided interim guidance, including in section 3.0 reliance standards for private foundations making grants to supporting organizations that purported to be functionally integrated with a supported organization. An Advance Notice of Proposed Rulemaking (ANPRM) (REG-155929-06, 8/2/07) described proposed rules to implement PPA changes to the Type III supporting organization rules. A Notice of Proposed Rulemaking (NPRM) (REG-155929-06, 9/24/09) provided Proposed Regulations ("the 2009 Proposed Regulations") regarding the requirements to qualify as a Type III supporting organization and permitted private foundations to continue to rely on the guidance in Notice 2006-109 with respect to functionally integrated Type III supporting organizations until the Proposed Regulations became temporary or final. See generally Flynn and Fleming, "The Impact of the Recent Proposed Regulations on Type III Supporting Organizations," 111 JTAX 354 (December 2009).

<sup>22</sup>

Reg. 1.509(a)-4(i)(3).

<sup>23</sup>

Reg. 509(a)-4(i)(3)(iv), Examples 1 and 2.

<sup>24</sup>

The "telephonic" meetings were added in the 2012 final and Temporary Regulations. The earlier Proposed Regulations mentioned

only face-to-face meetings.

<sup>25</sup>

An IRS speaker has said that he thought a representative of individual trustees would be consistent with the circumstances described in Example 1.

<sup>26</sup>

Reg. 1.509(a)-4(i)(3)(iii).

<sup>27</sup>

See note 16, *supra*.

<sup>28</sup>

Section 4942(g)(4)(A)(i).

<sup>29</sup>

Section 4945(d)(4)(A)(ii).

<sup>30</sup>

See note 21, *supra*.

<sup>31</sup>

The IRS issued a Memorandum on 2/4/13 to the Manager of EO determinations, directing her to begin issuing determination letters under the criteria set forth in the 2012 final and Temporary Regulations.

<sup>32</sup>

The Preamble to TD 9605 permits an organization to meet the functionally related test on the basis of the new rules or by continuing to meet the but for test under the prior Regulations until the first day of its second tax year beginning after 12/28/12 (that is, until 2014 for an organization reporting on a calendar-year basis).

<sup>33</sup>

See Reg. 1.509(a)-4(i)(4)(v), Examples 3 and 4.

<sup>34</sup>

*Id.*, Example 2.

<sup>35</sup>

See Reg. 1.509(a)-4(i)(4)(ii)(C).

<sup>36</sup>

See Reg. 53.4945-4(b).

<sup>37</sup>

See Regs. 53.4942(b)-1(b)(2)(ii) and 1.509(a)-4(i)(4)(v), Example 4.

<sup>38</sup>

Regs. 1.509(a)-4(i)(4)(i)(B) and 1.509(a)-4(i)(4)(iii).

<sup>39</sup>

Reg. 1.509(a)-4(i)(4)(v), Example 1. The Preamble to TD 9605, *supra* note 2, states (in part 6) that Treasury and the IRS intend to issue Proposed Regulations that will provide a new definition of "parent" that specifically addresses the power to remove and replace

officers, directors, or trustees of the supported organization.

<sup>40</sup>

Reg. 1.509(a)-4(i)(4)(iv) [reserved].

<sup>41</sup>

Regs. 1.509(a)-4(i)(5)(i)(A) and 1.509(a)-4(i)(5)(ii).

<sup>42</sup>

Regs. 1.509(a)-4(i)(5)(i)(A) and 1.509(a)-4(i)(5)(iii).

<sup>43</sup>

Regs. 1.509(a)-4(i)(5)(i)(B) and 1.509(a)-4(i)(9). A trust (whether or not exempt from taxation) that on 11/20/70 met and continues to meet the alternate requirements is treated as meeting the special "integral part" test for non-functionally integrated Type III supporting organizations. A trust meets the alternate requirements if (1) all the unexpired interests in the trust are devoted to one or more charitable, etc., purposes described in Section 170(c)(1) or (c)(2)(B) and a deduction was allowed for such interests under income, trust, estate, or certain other tax rules; (2) the trust was created prior to 11/20/70 (including an irrevocable split-interest trust described in Section 4947(a)(2) that became a charitable trust described in Section 4947(a)(1) after that date) and did not receive any grant, contribution, bequest, or other transfer on or after such date; (3) the trust is required by its governing instrument to distribute all of its net income currently to a designated (either specifically or by particular description) beneficiary supported organization (or in fixed shares to each of more than one such organizations); (4) the trustee of the trust does not have discretion to vary either the beneficiary or the amounts payable to the supported organizations (other than discretionary payments of principal or cessation of payments for specific circumstances stated in the trust); (5) none of the trustees would be "disqualified persons" (e.g., members of the ancestral or descendant family, substantial contributors, and certain related persons) within the meaning of Section 4946(a) (other than foundation managers under Section 4946(a)(1)(B) with respect to the trust if such trust were treated as a private foundation); and (6) for tax years beginning after 10/16/72 the trustee of such trust makes annual written reports to all of the trust's supported organizations, setting forth a description of the trust's assets, including a detailed list of the assets and the income produced by such assets. Although the Regulations have never been specific on this matter, the authors believe that "net income" for grandfathered trusts means trust accounting income under the applicable state's principal and income act (usually not including short-term or other capital gains), rather than "adjusted net income" (including short-term capital gains) as used for purposes of the attentiveness test described in the text for other Type III supporting organizations.

<sup>44</sup>

Temp. Reg. 1.509(a)-4T(i)(5)(ii)(B).

<sup>45</sup>

Temp. Reg. 1.509(a)-4T(i)(8).

<sup>46</sup>

Reg. 1.509(a)-4(i)(7).

<sup>47</sup>

Reg. 1.509(a)-4(i)(6)(i). But such amounts might not include amounts paid "for the use of" the supported organizations. The Preamble to TD 9605, part 6.b., states that "[t]he Treasury Department and the IRS do not agree that the term 'for the use of' is synonymous with 'on behalf of' or that it permits grants to organizations other than the supported organizations to count toward the distribution requirement." Nevertheless, Reg. 1.509(a)-4(i)(5)(ii)(A) (which discusses the distribution requirement for purposes of meeting the integral part test) states that "a supporting organization must distribute to or *for the use of* one or more supported organizations" an amount equal to or in excess of the distributable amount for that year (emphasis added).

<sup>48</sup>

Regs. 1.509(a)-4(i)(6)(ii), (iii), and (iv).

49

Reg. 1.509(a)-4(i)(6)(v).

50

Reg. 1.509(a)-4(i)(5)(iii)(C).

51

Preamble to TD 9605, *supra* note 2, part 6.b. For more on program-related investments generally, see Levitt and Wexler, "Proposed Regulations Would Bring Program-Related Investments Into the 21st Century," 117 JTAX 100 (August 2012); Chiodini and Levitt, "Program-Related Investing in L3Cs: A Question-and-Answer Guide," 118 JTAX 41 (January 2013).

52

Reg. 1.509(a)-4(i)(11)(ii)(B).

53

*Id.*

54

Reg. 1.509(a)-4(i)(5)(iii).

55

Reg. 1.509(a)-4(i)(5)(iii)(B).

56

Regs. 1.509(a)-4(i)(1) and (2).

57

Reg. 1.509(a)-4(i)(11)(i).

58

Reg. 1.509(a)-4(i)(10).

59

Reg. 1.509(a)-4(f)(5).

60

*Id.*

61

*Id.* The Section 4958 (intermediate sanctions) definition of family members is different and broader (it includes siblings) than the private foundation definition of family members who are disqualified persons under Section 4946.

62

Preamble to TD 9605, *supra* note 2, part 2.

63

Reg. 53.4943-11(f).

64

Reg. 53.4943-11(g).

