

**Supporting Organizations and Other Entities
(After the Pension Protection Act)**

I. Type of Federal Charitable Classification

II. Choice of State Law Entity Type

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Type of Federal Charitable Classification After the Pension Protection Act

Supporting Organizations

- A grant, loan, compensation, or “similar payment” (includes reimbursement of expenses) to a substantial contributor, to the contributor’s relatives or to a business controlled by the contributor or family members is prohibited. § 4958(c)(3).

Relatives include spouse, ancestor, sibling, child, grandchild, great-grandchild, or a spouse of one of such relatives.

An entity in which a substantial contributor or a family member owns, separately or collectively, more than 35% of the total combined voting power (of a corporation), profits interest (of a partnership) or beneficial interest (of a trust or estate).

Substantial contributor is any person who contributed or bequeathed an aggregate amount of more than \$5,000 to the organization, if the amount is more than 2% of the total contributions and bequests received by the organization throughout its existence and before the end of the taxable year of the payment in question. For a trust, the term includes the creator of the trust regardless of the amount contributed by this person. § 4958(c)(3)(C).

Reasonable compensation is not a safe harbor under this rule.

- Loans to any “disqualified person” are prohibited. § 4958(c)(3)(A)(i)(I).

“Disqualified persons” include substantial contributors, family members and controlled entities, as well as officers, board members, and other managers. They are persons who, at any time during a five-year period ending on the date of the transaction, was in a position to exercise substantial influence over the affairs of the organization, along with that person’s family members and controlled entities.

- Grants from private foundations no longer will qualify as qualifying distributions under § 4942 if a disqualified person with respect to the donor private foundation directly or indirectly controls the donee SO or any public charity supported by the SO. § 4942(g).

Pursuant to Notice 2006-109, an organization is controlled by one or more disqualified persons with respect to a foundation if any such persons may, by aggregating their votes or positions of authority, require the supporting or supported organization to make an expenditure, or prevent the supporting organization or the supported organization from making an expenditure, regardless of the method by which the control is exercised or exercisable.

- Grants from private foundations described immediately above will be taxable expenditures under § 4945 unless expenditure responsibility is exercised. § 4945(d)(4)(A).

- For purposes of the excess benefit transaction rules applicable to public charities under § 4958, a “disqualified person” of a supporting organization is also a disqualified person of each and every supported organization.

Again, “disqualified persons” are persons who, at any time during a five-year period ending on the date of the transaction, was in a position to exercise substantial influence over the affairs of the organization, along with that person’s family members and controlled entities.

For purposes of this rule, only the excess above fair market value is subject to penalty.

Type III Supporting Organizations (Non-functionally integrated)

- Grants from private foundations no longer will qualify as qualifying distributions under § 4942. § 4942(g)(4).
- Grants from private foundations will be taxable expenditures under § 4945 unless expenditure responsibility is exercised. § 4945(d)(4)(A).
- Excess business holdings rules previously applicable only to private foundations under § 4943 are applicable. § 4943(f)(1), (3)(A). **(This rule also applies to Type II supporting organizations if they accept a contribution from a person (other than a public charity, not a supporting organization) who controls, either alone or with family members and/or certain controlled entities, the governing body of a supported organization of the SO. § 4943(f)(1), (3)(B).)**
- May not support foreign charities. § 509(f)(1).
 - if supporting a foreign charity on August 17, 2006, may continue only until the first day of the organization's third taxable year beginning after August 17, 2006. § 509(f)(1)(B)(ii).
- Certain information must be provided to supported charities. § 509(f)(1).
- Public charity tax status will be lost if accept a contribution from a person (other than a qualified supported organization) who directly or indirectly controls a supported charity of the supporting organization, is a relative of such a person, or is an entity controlled by such a person (**this rule also applies to Type I supporting organizations**). § 509(f)(2).
- A "significant" minimum payout requirement (of a percentage of either income or assets) will be imposed in new regulations.
 - Under the Advance Notice of Proposed Rulemaking, the proposed payout is the same 5% distribution requirement imposed on private foundations under § 4942.

A *functionally integrated Type III Supporting Organization* is one that performs functions or carries out purposes of the supported organization or that conducts activities that would normally be performed by the supported organization if the type III SO did not exist. § 4943(f)(5)(B).

In addition, a functionally integrated Type III SO may be required to meet certain tests of income or assets under the Advance Notice of Proposed Rulemaking, notwithstanding its definition as a Type III SO that is *not* required by the tax regulations to make payments to supported organizations. § 4943(f)(5)(B).

Expedited procedure exists to convert from § 509(a)(3) tax classification to § 509(a)(1) or (a)(2) tax classification under Announcement 2006-93.

Donor-Advised Funds

- Grants may not be made to any natural person or to any other person unless the community foundation exercises expenditure responsibility under § 4945. Excluded from this rule are grants to any organization described in § 170(b)(1)(A) except for grants to Type III, non-functionally integrated supporting organizations or to other supporting organizations in which a donor or advisor controls a supported charity. § 4966(c)(2)(A).

Pursuant to Notice 2006-109, a supported organization is controlled by one or more donor or donor advisors (and any related parties) of any donor advised fund if any such persons may, by aggregating their votes or positions of authority, require the supported organization to make an expenditure, or prevent the supported organization from making an expenditure, regardless of the method by which the control is exercised or exercisable.

- A grant, loan, compensation, or “similar payment” (includes reimbursement of expenses) from a donor-advised fund to a donor, an advisor, or members of their families or businesses in which they have a substantial interest is prohibited. § 4958(c)(2).
- Penalties are imposed when a donor, advisor, or a person related to a donor or advisor receives a benefit from a grantee organization that is more than incidental. § 4967(a)(1).

A benefit is more than “incidental” if it would reduce the recipient’s charitable income tax deduction if she or he had made a contribution directly to the donee charity.

- Excess business holdings rules previously applicable only to private foundations under § 4943 are applicable. § 4943(e)(1).

For this purpose, a “disqualified person” means a donor, donor advisor, member of the family of either, or a 35% controlled entity of any such person. § 4943(e)(2).

- Donors may claim tax deductions for contributions to a DAF only if they receive a written acknowledgment from the community foundation stating that the foundation has exclusive legal control over the contributed assets. §§ 170(f)(18)(B), 2055(e)(5)(B), 2522(c)(5)(B).

Definition of Donor-Advised Fund no longer includes funds that i) benefit only one charity or governmental unit or ii) makes grants for scholarships and similar purposes if the fund is advised by a committee wholly appointed by the community foundation and grants are made according to an “objective and nondiscriminatory” process that tracks the rules applicable to private foundations under § 4945 that make scholarship grants. § 4966(d)(2)(B). These funds, therefore, are not subject to excise taxes under new § 4966.

Pursuant to Notice 2006-109, employer-sponsored disaster relief assistance programs also are excluded from the definition of donor-advised fund under § 4966(d)(2)(A).

More to come: will DAFs be subject to minimum distribution requirements, and will retention of donor advisory rights continue to be consistent with the tax treatment of donations as completed gifts?

Private Foundations

- Grants from private foundations to any supporting organization no longer will qualify as qualifying distributions under § 4942 if a disqualified person with respect to the donor private foundation directly or indirectly controls the donee SO or any public charity supported by the SO. § 4942(g).
- Grants from private foundations described immediately above will be taxable expenditures under § 4945 unless expenditure responsibility is exercised. § 4945(d)(4)(A).
- Grants from private foundations to a Type III non-functionally integrated supporting organization no longer will qualify as qualifying distributions under § 4942. § 4942(g)(4).
- Grants from private foundations to a Type III non-functionally integrated supporting organization will be taxable expenditures under § 4945 unless expenditure responsibility is exercised. § 4945(d)(4)(A).
- The situations in which the § 4940 excise tax on net investment income are expanded. § 4940(c)(2).

property that generally produces capital gains through appreciation, but not interest, dividends, rents, or royalties (such property arguably includes timberlands)

capital gains and losses from the sale or other disposition of exempt-purpose or program-related investments

income from notional principal contracts, annuities, and other substantially similar income from ordinary and routine investment

**CHOICE OF STATE LAW ENTITY
AFTER THE PENSION PROTECTION ACT**

- Upon review, counsel has decided that either a supporting organization or a private foundation makes sense
- As a result, counsel now needs to select the type of state law entity that would be appropriate for the supporting organization or private foundation:
 - Charitable Trust
 - Can have as few as one trustee
 - Higher fiduciary duties for trustees?
 - Lesser state law filing requirements?
 - Less rigid structure - good for families?
 - Less rigid structure - bad for disputes?
 - Doesn't fit in a Sarbanes-Oxley world
 - Nonprofit Corporation
 - In most states, 3 directors, but some variation
 - Business judgment rule plus?
 - Secretary of State filings
 - Precedent and statutory guidance on governance
 - Unincorporated Association -- *let's just forget that one right now....*
- Supporting Organizations in Trust Form
 - Prior to the PPA, Type III Supporting Organizations were often created in Trust form -- Why?
 - In order to be a Type III Supporting Organization, the charity had to meet the "responsiveness test" and the "integral part" test. Treas. Reg. §1.509(a)-4(i)(1)(i).
 - There were two alternative ways to meet the "responsiveness test"
 - Have the officers, trustees or directors of the supporting organization on the governing body of, or otherwise involved in, the operations of the Supporting Organization, OR
 - If the supporting organization is a charitable trust under state law and the supported organization is named in the document and can compel an accounting, that is sufficient.

- PPA Change
 - Section 1241(c) of the PPA specifically provides that merely being a charitable trust with a named beneficiary who can demand an accounting is NOT sufficient to meet the responsiveness test.
 - BUT -- the responsiveness test remains....
 - SO -- how does a charitable trust meet the responsiveness test?

- Meeting the Responsiveness Test in a Charitable Trust World
 - The Responsiveness Test in detail:
 - One or more trustees are elected or appointed by the supported organizations OR
 - One or more of the trustees overlaps with the governing body of the supported organization OR
 - There is a "close and continuous working relationship" between the trustees and the governing body of the supported organization.
 - As a result of one of these relationships, the supported organization as a "significant voice in the investment policies, timing and making of grants, and otherwise directing the use or income of the assets of the Supporting Organization

 - Trust Administration and Fiduciary Issues
 - If you need to have an appointed or overlapping board -- how many Trustees are too many? Difficulties operating under state law --how many signatures? What kind of a vote? There are no officers?
 - Can you have just one Trustee with an advisory board - trouble for corporate trustees of supporting organizations?
 - Would acting on a non-binding advisory board be sufficient to have a "close and continuous" working relationship that has a "significant voice"
 - Duty of impartiality among beneficiaries - what happens when there are multiple supported organizations?
 - Limits on the ability to delegate investment authority
 - See the discussion of this issue in this Group's IRS comments dated January 3, 2008, located at http://meetings.abanet.org/webupload/commupload/RP529000/otherlinks_files/Comments-Sections509and4943.pdf.

