



IRS Issues New Guidance to Nonprofit Supporting Organizations

The IRS has issued new guidance regarding supporting organizations, which are entities that obtain public charity status by virtue of their relationship with other public charities. Typically, a nonprofit that receives income from a small number of donors, such as a family foundation, would be characterized as a private foundation (not a public charity) and subject to applicable excise taxes and other stringent regulations. However, if special rules are met, an entity funded by one donor, such as a testamentary trust established to support one or more art museums in a specific locale, can be classified as a supporting organization, and therefore a public charity. In essence, supporting organizations are public charities that have a limited donor base as well as a specified grantee base—the supported organizations—along with a defined relationship to the respective supported organizations.

There are three types of supporting organizations: Type I and Type II organizations, which are operated, supervised or controlled by one or more supported organizations in a manner similar to a parent-subsidiary relationship or brother-sister relationship, respectively. The third category, Type III supporting organizations, are “operated in connection” with their supported organizations and must satisfy complex relationship rules to qualify as public charities.

Most significantly, in September, 2009, the IRS issued Proposed Treasury Regulations addressing the two categories of Type III supporting organizations created

by the Pension Protection Act of 2006 (PPA): those that are “functionally integrated” with their supported organizations and those that are not. Under the Proposed Regulations, all supporting organizations must comply with complicated relationship rules in order to be classified as public charities. Thus, in accordance with the PPA, the Proposed Regulations eliminate a special rule that allowed charitable trusts to qualify as Type III organizations if they met state law requirements. Another provision of the Proposed Regulations reflects the PPA’s provision that *minimum payout rules* be established for nonfunctionally integrated Type III supporting organizations; such organizations must pay out 5% of the fair market value of non-exempt use assets each year. However, the Proposed Regulations omit a restriction on the number of organizations that can be supported (as contained in preliminary guidance), but do prohibit support of foreign entities as well as contributions from certain disqualified persons.

The IRS has also issued administrative rulings regarding supporting organizations. The first, Announcement 2009-62, was issued in recognition of the fact that some organizations may no longer qualify as supporting organizations as a result of the above-described restrictions. Announcement 2009-62 accordingly sets forth procedures for supporting organizations seeking clarification or change in status as public charities. These requests will not be processed on an expedited basis unless certain criteria are met. However, IRS officials

have also stated that existing supporting organizations can request, at no cost, an IRS written determination as to their status as long as they satisfy the standards set forth in current regulations or in the Proposed Regulations with the caveat that those organizations relying on current regulations may do so only until the effective date of final or temporary regulations.

In another ruling, Revenue Procedure 2009-32, the IRS formalized guidelines allowing grantors (private foundations and sponsoring organizations of donor-advised funds), who need to determine whether a potential grantee is a supporting organization, to rely on third party information as to its public charity status. Thus, grantors can rely on information in the IRS Business

Master File (BMF) as well as information from a third-party provider of BMF information that meets specified criteria, such as GuideStar, as the first step in making a public charity determination. Nonetheless, a grantor must still determine the precise classification of a supporting organization so as not to run afoul of expenditure responsibility rules or minimum distribution requirement rules when making a grant to a nonfunctionally integrated Type III organization.

This is a highly complex area; please feel free to contact any of the attorneys in our exempt organizations practice group listed below should you have questions or need further guidance. ■

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