



Overview

A supporting organization is a special type of entity that, based on its close relationship with a public charity, is itself classified as a public charity rather than a private foundation, even though it may be funded by only one donor.

Since the adoption of the Tax Reform Act of 1969, charitable organizations which qualify as exempt under Section 501(c)(3) of the Internal Revenue Code (IRC) are classified as either public charities or private foundations based on Section 509 "public support" tests. Organizations classified as public charities are subject to less restrictions and yield greater tax deductions than those classified as private foundations. Public charities are generally afforded these advantages due to Congress's belief that if the public is heavily involved in the funding and/or operation of a charity, that charity will be less likely to operate for the private benefit of those in control. By the same logic, supporting organizations are deemed to be under the same public scrutiny as the public charity it supports, and are thus "exempted" from satisfying the public support test.

Supporting organizations are most appropriate for the donor who wants to make a current gift while maintaining continued influence over the distributions to the charity or charities it supports, and where the donor is willing to share control with the charity. With regard to issues of donor control, restrictive regulations, and cost of compliance, support organizations lie somewhere in between private foundations and donor advised funds. Similar to private foundations, the donor, through a board of directors, may recommend grants and investments, but the parent organization has significant input in all final decisions (similar to a donor advised fund). However unlike a donor advised fund, the supporting organization is a distinct and separate entity from the supported charity, with potentially different investment philosophies and grant criteria. This independence from the supported charity may lend a greater feeling of control to the donor than would a donor advised fund. While the costs to operate and monitor a supporting organization can approach that of a private foundation, the burden can be shared with the supported charity.

Requirements

Like all charitable organizations, a supporting organization must be organized and operated exclusively for the purposes described in IRC Section 501(c)(3). In addition, under IRC Section 509(a)(3), the supporting organization must satisfy an organizational test, an operational test, a control trust, and a relationship test.

The organizational and operational tests generally require that the supporting organizations be organized, and at all times thereafter, operated exclusively for the benefit of, or perform the functions of or carry out the purposes of one or more specified charities. A supporting organization's purposes can be as broad as, but not broader than, the charitable purposes of the supported charity or charities.

The control test requires that the supporting organization not be controlled directly or indirectly by a disqualified person. A disqualified person generally includes a substantial contributor or family member of a substantial contributor. The founder of a supporting organization is permitted to serve on the board, as well as the founder's spouse. The only requirement is, as "disqualified persons," they may not "control" the board. They may, however, hold a "minority" voting position. For example, if the supporting organization has a five person board, the founder and spouse may serve as directors. The other three board members may be friends. "Control" refers to voting power, not persuasion.

The relationship test requires that the organization be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. Under IRC Section 509(a)(3)(b), there are three different types of supporting organizations, distinguished by the amount of control the supported public charity can exercise over it.

- ◆ Type I supporting organizations are operated, supervised, or controlled by the supported organization, in a relationship resembling a parent and subsidiary corporation. The supported organization holds a substantial degree of authority over the supporting organization's policies, programs, and activities. The Pension Protection Act of 2006 (PPA 2006) provides that a Type I supporting organization will be converted to a private foundation if gifts are accepted from a control person and gifts will not be deductible if the organization is controlled by a donor or advisor.
- ◆ Type II supporting organizations are supervised or controlled in connection with the supported organization in a relationship resembling that of brother and sister corporations, with the supported and supporting organizations under common control.
- ◆ Type III supporting organizations are operated in connection with or functionally integrated with the supported organization. This relationship requires the least supervision by the publicly supported organization and up until recently, was the most commonly used of the three types. However, the addition of more restrictive provisions within the PPA 2006 and subsequent Treasury regulations have made this option less attractive.

A Type III supporting organization must make distributions each year to one or more of the public charities named in its trust document (i.e., a community foundation). Distributions do not have to be made equally to each charity nor do distributions have to be made each year to every charity named in the trust. In fact, distributions may be made to only one of the listed

charities, as long as the support that it receives is sufficient to ensure its "attentiveness" to the supporting organization operations.

Unlike a private foundation, the minimum amount to be distributed each year by a supporting organization is based on its income and not on its assets. Functionally integrated Type III supporting organizations must distribute at least 85% of its adjusted net income (excluding capital gains) realized each year.

The Pension Protection Act of 2006 also mandated that every supporting organization must indicate on its Form 990 which type of supporting organization it is, and which organization (or organizations) it supports. The organization must also provide certification regarding controlling individuals. The act also prohibits any supporting organization from providing grants, loans, or compensation to substantial contributors, their families, or other entities significantly controlled by them. Private foundations may not make qualifying distributions to supporting organizations that are directly or indirectly controlled by significant persons at the private foundation.

Tax Ramifications

Gifts to supporting organizations are deductible to the same extent as gifts made to "public charities." Generally, this means cash donations are deductible up to 60% of the individual donor's adjusted gross income (AGI). Gifts of appreciated property are deductible up to 30% of the individual donor's AGI. In contrast, the deductibility of gifts to a private foundation is considerably more limited, i.e., 30% limit for cash gifts and 20% limit on gifts of appreciated property. Furthermore, gifts of appreciated property to a private foundation in most cases are deductible only "at basis" (not fair market value).

Type I, II, and functionally integrated Type III organizations are tax exempt. They are not subject to the 2% excise tax on private foundations. However, certain excise taxes on certain prohibited activities applicable to private foundations that make grants to controlled organizations also apply to supporting organizations. Supporting organizations must file an annual tax return (Form 990) and may also be subject to state tax reporting requirements.



Atlantic Financial Group, LLC

Brett Sause*, LUTCF®, LTCP®, CLTC®, FSCP®

8706 Commerce Drive, Suite 1, Easton, MD 21601

Phone: (443)249-3311

brett@atlanticfinancialgroup.org

*Registered Representative offering securities through NYLIFE Securities LLC, Member FINRA/SIPC, a Licensed Insurance Agency, (8706 Commerce Drive, Suite 1, Easton, MD 21601). Member Agent of The Nautilus Group®, a service of New York Life Insurance Company.

This tax-related discussion reflects an understanding of generally applicable rules and was prepared to assist in the promotion or marketing of the transactions or matters addressed in this material. It is not intended (and cannot be used by any taxpayer) for the purpose of avoiding any IRS penalties that may be imposed upon the taxpayer. New York Life Insurance Company, its agents and employees may not give legal, tax or accounting advice. Please consult your own professional advisors before making any decisions.

This information was produced by New York Life Insurance Company and provided as a courtesy by Brett Sause. © 2016 New York Life Insurance Company. All rights reserved. SMRU 461664 (exp. 2.28.2020)