



LGT

FINANCIAL FOCUS



Lane Gorman Trubitt, L.L.P.
Accountants & Advisors

Your Accounting for a New Economy

Type III Supporting Organizations Face PPA Changes From Proposed IRS Regulations

The IRS has issued proposed regulations intended to explain many of the changes made by the Pension Protection Act of 2006 (PPA) to the rules governing Type III supporting organizations. The proposed regulations provide new requirements for qualification and notification as well as new policies for how these organizations meet the responsiveness and integral part tests.

As you may be aware, tax-exempt charitable organizations that are classified as private foundations are subject to a number of specialized rules which vary depending upon their status as operating or non-operating private foundations. However, an organization can avoid classification as a private foundation and be treated as a public charity if it falls within one of several categories – one of which is a supporting organization as described under Code Sec. 509(a)(3). However, in order to qualify as a supporting organization it must satisfy specific organizational, operational, relationship and disqualified person control tests.

Reg. § 1.509(a)-4(f)(2) details three operational relationships a supporting organization may have with its supported organization(s), the third of which is known as a Type III organization. A Type III supporting organization describes a supporting organization operated in connection with one or more publicly supported organizations.

Important Changes

The changes made to the PPA by the proposed IRS regulations effect these Type III organizations and include changes to the following:

- The responsiveness test for charitable trusts
- New payout requirement for organizations that are not functionally integrated
- Requires Type III supporting organizations to provide information to their supported organization every year to demonstrate responsiveness to the needs and demands of its supported organization
- Type III supporting organizations are now prohibited from supporting any supported organization not organized in the U.S.

- Type I and Type III supporting organizations are now prohibited from accepting a gift or contribution from a person who, together with certain related persons, directly or indirectly controls the governing body of the supported organization

Qualification Criteria

The IRS has also issued a new set of proposed regulations to provide guidance on how supporting organizations can qualify as a Type III supporting organization under the new PPA.

According to the new proposed regulations all Type III supporting organizations must:

- Satisfy the notification requirement in Reg. § 1.509(a)-4(i)(2)
- Meet the responsiveness test in Reg. § 1.509(a)-4(i)(3)
- Demonstrate that it is an integral part of one or more supported organizations by satisfying either the requirements for functionally integrated Type III supporting organizations in Reg. § 1.509(a)-4(i)(4), or the requirements for non-functionally integrated Type III supporting organizations in Reg. § 1.509(a)-4(i)(5). (Prop. Reg. § 1.509(a)-4(i)(1))

In addition, Type III supporting organizations must not:

- Support a supported organization organized outside of the U.S.
- Accept a gift or contribution from a person who, together with certain related persons, directly or indirectly controls the governing body of the supported organization

Notification Requirement

Type III supporting organizations are required to provide the following information to their supported organizations:

- Written notice addressed to the principal officer of the supported organization identifying the Type III supporting organization and describing the amount and type of support provided in the past year (Prop. Reg. § 1.509(a)-4(i)(2))
- Copy of the Type III supporting organization's most recently filed Form 990 Return of Organization Exempt from Income Tax (Prop. Reg. § 1.509(a)-4(i)(2))
- Copy of the Type III supporting organization's governing documents, including any amendments. The governing documents need only be provided once and can be delivered to the supported organization electronically. (Prop. Reg. § 1.509(a)-4(i)(13))

Integral Part Test – Functionally Integrated

The proposed regulations (Prop. Reg. § 1.509(a)-4(i)(4)) state that a Type III supporting organization is functionally integrated if it fulfills any of the following:

- Engages in activities substantially all of which directly further the exempt purposes of the supported organization(s) by performing the functions of, or carrying out the purposes of, such supported organization(s) and that, but for the involvement of the supporting organization, would normally be engaged in by the supported organization(s)
- Is the parent of each of its supported organizations

Integral Part Test – Non-Functionally Integrated

According to the new proposed regulations, a Type III supporting organization would not be non-functionally integrated if it satisfies a distribution requirement and an attentiveness requirement. (Prop. Reg. § 1.509(a)-4(i)(5))

To meet the distribution requirement, a Type III supporting organization that is not functionally integrated would have to distribute each tax year, to or for the use of its supported organizations, amounts equaling or exceeding 5% percent of the aggregate fair market value of its non-exempt-use assets, on or before the last day of the tax year. The annual distributable amount is determined by asset values measured over the preceding tax year.

Under an exception, an organization that fails to meet the distribution requirement would not be classified as a private foundation in the tax year for which it fails to meet the distribution requirement, if it establishes the following to IRS's satisfaction:

- Failure was due solely to an incorrect valuation of assets, a ministerial error, or unforeseen events or circumstances beyond the organization's control
- Failure was due to reasonable cause rather than willful neglect
- Distribution requirement is met within 180 days after the date the incorrect valuation or ministerial error was or should have been discovered, or 180 days after the organization is first able to make its required payout notwithstanding the unforeseen event or circumstances

Closing

Failure by a Type III supporting organization to meet the requirements of the new regulations once they have been published as final or temporary regulations would result in the organization being reclassified as a private foundation. If you have any questions about the new regulations and how they affect your organization do not hesitate to contact the trusted advisors at Lane Gorman Trubitt, L.L.P. You can reach Neely Duncan, Not-For-Profit Audit Manager at her direct line (214) 461-1437 or by email at nduncan@lgt-cpa.com.