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Navigating the Pension Protection Act: Distributions to Section 509(a)(3) Supporting Organizations



By Dianne Chipps Bailey

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Dear NCNG Esquire:

I have heard that the Pension Protection Act of 2006 restricts the ability of private foundations and donor advised funds to make gifts to supporting organizations. How should we respond to these new rules? Signed, Confused but wanting to comply...

The most conservative and least administratively burdensome response to the restrictions in the Pension Protection Act of 2006 (“PPA”) on the ability of private foundations and donor advised funds to make gifts to supporting organizations (“SOs”) is to adopt a policy prohibiting all such gifts. At first blush, a policy prohibiting gifts to SOs may seem too limiting; however, if you probe a bit further, you likely will find that it is possible to achieve your philanthropic goals notwithstanding this limitation and with the comfort of knowing that you are complying with the PPA. If you desire to continue making gifts to SOs, you may but only if you painstakingly follow the applicable rules or persuade the potential grantees to seek reclassification by the IRS.

A few words by way of background: Remember that an SO is an organization that typically would be classified as private foundation because it is funded by a single donor or small group of donors, but because of the SO’s relationship with one or more Section 509(a)(1) or Section 509(a)(2) public charities (“non-SO public charities”) the SO gains public charity status under Section 509(a)(3). SOs are further classified as Type I, Type II, functionally integrated Type III or non-functionally integrated Type III. Pursuant to the PPA, private foundations and donor advised funds are limited in their ability to make grants to (a) Type I, Type II or functionally integrated Type III SOs that are controlled by the grantor’s disqualified persons, donors, or donors advisors, as applicable (“insiders”), or that have supported organizations controlled by such insiders, and (b) non-functionally integrated Type III SOs. Such

grants will not count as qualifying distributions and, furthermore, will be deemed taxable expenditures unless the grantor exercises expenditure responsibility.

One response to these complex and often obtuse rules is simply to adopt a policy prohibiting gifts to SOs. If you were to adopt such a policy, you likely would be able to achieve your philanthropic goals simply by making gifts directly to non-SO public charities, rather than to the affiliated SOs. For example, if you desired to make a gift to an SO foundation affiliated with a non-SO public charity hospital, you could direct your gift to the hospital instead of the SO. The gift would be counted toward your minimum distribution requirement and no expenditure responsibility would be required.

If this strategy is not workable for your private foundation or donor advised fund, you may continue to make gifts to SOs within the parameters of the PPA. The most significant and difficult task may be determining a potential grantee's public charity status. You may rely on the potential grantee's determination letter, the IRS's Business Master File or a third party, such as Guidestar, in determining whether a potential grantee is a Section 509(a)(1), (2) or (3) public charity. If the organization is classified under Section 509(a)(1) or (2), your due diligence is complete. However, if the organization is classified under Section 509(a)(3) (i.e., an SO), you have additional work to do.

Before making a grant to an SO, you must obtain a letter from the SO attesting to its status as Type I, Type II or functionally integrated Type III, together with certain supporting documentation. Then you must carefully review the letter and the supporting documentation and independently determine that they are consistent. Such a determination entails a rather complex analysis of, among other things, the governance structure of the SO and the organizations it supports. You also must review the governance documents of the SO's supported organizations and confirm that those organizations are not controlled by any of your insiders. If you are not comfortable making such a determination, you may instead obtain and rely upon a reasoned opinion of counsel as to the SO's status. A legal opinion may be preferable to a letter from the grantee but also generally will be substantially more expensive. Ultimately, you likely will find that the most efficient response to the dilemma created by the PPA for many SOs is simply seeking reclassification by the IRS as a Section 509(a)(1) or (2) public charity.