



January 2013

A Tax & Business Planning Update

## Treasury and IRS Issue Final and Temporary Type III Supporting Organization Regulations



Overview of Key Provisions

*Integral Part Test—Non-Functionally Integrated Type III Supporting Organizations* ..... 2

*Integral Part Test—Functionally Integrated Type III Supporting Organizations*

*What You Need To Do Now* ..... 3

**O**n December 21, 2012, the Department of Treasury and Internal Revenue Service issued final and temporary regulations regarding the requirements to qualify as a Type III supporting organization, which is one that is *operated in connection with* one or more supported organizations. The final regulations make various revisions to the proposed regulations issued by Treasury and the IRS in 2009, which reflect changes to the law made by the Pension Protection Act of 2006. The temporary regulations revise the payout requirements for a non-functionally integrated Type III supporting organization.

### What You Need To Know

#### Background

- An organization described in Section 501(c)(3) of the Internal Revenue Code (the “Code”) is classified as either a private foundation or a public charity. To be classified as a public charity, an organization must meet the requirements of Section 509(a) (1), (2), (3), or (4) of the Code. Organizations described in Section 509(a)(3) of the Code are known as supporting organizations. Supporting organizations qualify as public

charities because they support either another public charity or the charitable activities of a 501(c)(4), (5), or (6) organization. There are four types of supporting organizations:

- ◇ **Type I** – a supporting organization that is under direct control of the supported organization (also known as “parent/subsidiary” organizations)
  - ◇ **Type II** – a supporting organization that is under common control with the supported organization (also known as “brother/sister” organizations)
  - ◇ **Type III** – a supporting organization that is functionally integrated with one or more supported organizations (also known as a “functionally integrated Type III supporting organization”)
  - ◇ **Type III** – a supporting organization that is not functionally integrated with one or more supported organizations (also known as a “non-functionally integrated Type III supporting organization”)
- All supporting organizations must satisfy an organizational test, an operational test, a relationship test, and a disqualified person control test.
  - The final and temporary regulations focus primarily on the relationship tests for Type III supporting organizations.
  - One of the major provisions in the 2009 proposed regulations relates to the amount that non-functionally integrated Type III supporting organizations must annually distribute. These provisions have been significantly revised in response to comments from the public. These provisions and provisions related to how assets are valued for purposes of this distribution requirement are being issued as temporary regulations to permit additional opportunity for comment.

## Overview of Key Provisions

### *Integral Part Test – Non-Functionally Integrated Type III Supporting Organizations*

The key change to the 2009 proposed regulations relates to the distribution requirements for non-functionally integrated Type III supporting organizations. The 2009 proposed regulations provided that a non-functionally integrated Type III supporting organization would have to meet a payout requirement equal to 5 percent of the fair market value of its non-exempt use assets to the supported organizations. This distribution requirement was met with criticism from both practitioners and exempt organizations. In response, Treasury the IRS have issued temporary and proposed regulations that now require non-functionally integrated Type III supporting organizations to annually distribute the greater of 85 percent of adjusted net income or 3.5 percent of the fair market value of the supporting organization’s exempt use assets.

In addition, the final regulations provide that a non-functionally integrated Type III supporting organization can count toward the distribution requirement amounts expended on activities that directly further the exempt purposes of the supported organization(s) to which the supporting organization is responsive and that, but for the involvement of the supporting organization, would normally be engaged in by the supported organization(s).

The final regulations also clarify certain distributions that can count toward the distribution requirement, modify the



attentiveness requirement, and clarify how assets are valued for purposes of determining the distributable amount.

### *Integral Part Test – Functionally Integrated Type III Supporting Organizations*

Like the 2009 proposed regulations, the final regulations provide that a Type III supporting organization is *functionally integrated* with a supported organization, and thus is not subject to a distribution requirement, if it either (1) engages in activities substantially all of which directly further the exempt purposes of the supported organizations to which it is responsive, subject to certain other requirements; or (2) is the parent of each of its supported organizations.

The final regulations clarify that direct furtherance activities are activities conducted by the supporting organization itself, rather than by the supported organization. In addition, the final regulations provide that certain payments to individual beneficiaries, subject to certain restrictions, will be treated as direct furtherance activities under the Type III supporting organization functionally integrated test. However, the final regulations impose three additional requirements that a

supporting organization's grants, scholarships, or other payments to individual beneficiaries must satisfy in order to be considered direct furtherance activities.

The final regulations also contain various minor clarifications and revisions relating to, among others, the definition of a supporting organization, gifts from controlling donors, written notification provisions, and provide transition guidance and other relief provisions for Type III supporting organizations.

### What You Need to Do Now

If applicable, you should note the potential reduction in the payout requirement for non-functionally integrated Type III supporting organizations. In addition, you should determine how this more flexible distribution rule may benefit your organization and identify potential problems that your organization may encounter. Your organization may consider providing comments to the IRS regarding the new temporary and proposed regulations.

You also should review your activities periodically to ensure that your supporting organization is adhering to the requirements of the final regulations. ■



### For More Information

If you have questions regarding the final and temporary Type III supporting organization regulations, please contact:

- Thomas J. Schenkelberg | 816.360.4124 | [tschenkelberg@polsinelli.com](mailto:tschenkelberg@polsinelli.com)
- Douglas K. Anning | 816.360.4188 | [danning@polsinelli.com](mailto:danning@polsinelli.com)
- Virginia C. Gross | 816.360.4109 | [vgross@polsinelli.com](mailto:vgross@polsinelli.com)
- Bruce R. Hopkins | 816.360.4371 | [bhopkins@polsinelli.com](mailto:bhopkins@polsinelli.com)
- Lauren K. Mack | 312.873.3667 | [lmack@polsinelli.com](mailto:lmack@polsinelli.com)



## About our

### Nonprofit Organizations Group

Polsinelli Shughart is one of the nation's leading providers of legal services to nonprofit organizations. Our attorneys have made significant contributions to nonprofit organizations through innovative approaches to legal and organizational issues.

Staffed by nationally recognized experts with business acumen and in-depth industry knowledge, our nonprofit attorneys are well versed on the issues facing tax-exempt organizations. The Polsinelli Shughart Nonprofit Organizations team literally wrote the book on tax-exempt and nonprofit law. Between them, our attorneys have published more than 25 books in this area reflecting their extensive practical experience in strategically and proactively serving the needs of nonprofit clients. Four of our nonprofit attorneys recently collaborated on a book about IRS Form 990. The redesigned form is one of the most significant developments facing nonprofit organizations in many years. In addition, two of our members authored a Tax Management Portfolio, published by the Bureau of National Affairs, a well-known tax treatise.

To learn more about our services, visit us online at [www.polsinelli.com](http://www.polsinelli.com).

Thomas J. Schenkelberg  
*Chair*  
 Kansas City  
 816.360.4124  
[tschenkelberg@polsinelli.com](mailto:tschenkelberg@polsinelli.com)

Douglas K. Anning  
*Vice-Chair*  
 Kansas City  
 816.360.4188  
[dzimmerman@polsinelli.com](mailto:dzimmerman@polsinelli.com)

John S. Black  
 Kansas City  
 816.374.0580  
[jblack@polsinelli.com](mailto:jblack@polsinelli.com)

Scot W. Boulton  
*St. Louis*  
 314.889.7030  
[sboulton@polsinelli.com](mailto:sboulton@polsinelli.com)

Michael V. Conger  
 Kansas City  
 816.360.4145  
[mconger@polsinelli.com](mailto:mconger@polsinelli.com)

John F. Crawford  
*Chicago*  
 312.463.6320  
[jcrawford@polsinelli.com](mailto:jcrawford@polsinelli.com)

Geoffrey D. Fasel  
*Chicago*  
 816.360.4223  
[gfasel@polsinelli.com](mailto:gfasel@polsinelli.com)

Jeffrey E. Fine  
*St. Louis*  
 314.552.6824  
[jfine@polsinelli.com](mailto:jfine@polsinelli.com)

Virginia C. Gross  
 Kansas City  
 816.360.4109  
[vgross@polsinelli.com](mailto:vgross@polsinelli.com)

Bruce R. Hopkins  
 Kansas City  
 816.360.4371  
[bhopkins@polsinelli.com](mailto:bhopkins@polsinelli.com)

Alicia M. Kirkpatrick  
 Kansas City  
 816.572.4486  
[akirkpatrick@polsinelli.com](mailto:akirkpatrick@polsinelli.com)

D. Scott Lindstrom  
*Overland Park*  
 913.234.7509  
[slindstrom@polsinelli.com](mailto:slindstrom@polsinelli.com)

Lauren M. Mack  
 Chicago  
 312.873.3667  
[lmack@polsinelli.com](mailto:lmack@polsinelli.com)

Lisa D. McLaughlin  
*St. Louis (Clayton)*  
 314.889.7019  
[lmclaughlin@polsinelli.com](mailto:lmclaughlin@polsinelli.com)

Anthony Romano  
 Kansas City  
 816.360.4251  
[aromano@polsinelli.com](mailto:aromano@polsinelli.com)

Lisa Schultes  
 Kansas City  
 816.360.4114  
[lschultes@polsinelli.com](mailto:lschultes@polsinelli.com)



## About

---

### Polsinelli Shughart

With more than 600 attorneys, Polsinelli Shughart is a national law firm and a recognized leader in the areas of health care, financial services, real estate, life sciences and technology, energy and business litigation. Serving corporate, institutional and individual clients, our attorneys build enduring relationships by providing practical, business-driven legal advice with a commitment to helping clients achieve their objectives. The firm has offices in Chicago; Dallas; Denver; Kansas City; Los Angeles; New York; Phoenix; St. Louis; Washington, D.C.; and Wilmington. In California, Polsinelli Shughart LLP.

The firm can be found online at [www.polsinelli.com](http://www.polsinelli.com).

Polsinelli Shughart PC. In California, Polsinelli Shughart LLP.

## About

---

### This Publication

*If you know of anyone who you believe would like to receive our e-mail updates, or if you would like to be removed from our e-distribution list, please contact us via e-mail at [Interaction@polsinelli.com](mailto:Interaction@polsinelli.com).*

*Polsinelli Shughart provides this material for informational purposes only. The material provided herein is general and is not intended to be legal advice. Nothing herein should be relied upon or used without consulting a lawyer to consider your specific circumstances, possible changes to applicable laws, rules and regulations and other legal issues. Receipt of this material does not establish an attorney-client relationship.*

*Polsinelli Shughart is very proud of the results we obtain for our clients, but you should know that past results do not guarantee future results; that every case is different and must be judged on its own merits; and that the choice of a lawyer is an important decision and should not be based solely upon advertisements.*

*Polsinelli Shughart PC. In California, Polsinelli Shughart LLP.*

*Polsinelli Shughart® is a registered trademark of Polsinelli Shughart PC.*

