

B. EXCLUSION FROM PRIVATE FOUNDATION STATUS UNDER IRC 509(a)(3)

1. Introduction - The Term "Private Foundation"

Organizations described in IRC 501(c)(3), that meet the requirements of IRC 509(a)(3), are commonly referred to as "supporting organizations." By virtue of their classification under IRC 509(a)(3), such organizations are excepted from being "private foundations." This article is intended to recite, in a readable fashion, the law and regulations applicable to supporting organizations, highlight particularly difficult or controversial areas, and reference significant court decisions and revenue rulings.

The classification, "private foundation," made its statutory appearance in the Tax Reform Act of 1969. This classification, with its attendant restrictions on organizations so classified, arose from the congressional conclusion that organizations described in IRC 501(c)(3) that neither depend on public support nor conduct an inherently public activity, may be more responsive to the private interests of their creators than the public interests they purport to serve.

In adopting the "private foundation" classification, Congress cast a wide net. First of all, the definition is inclusive - IRC 509(a) defines a private foundation as any domestic or foreign organization described in IRC 501(c)(3), other than one able to qualify under one of the four exclusion categories listed in IRC 509(a)(1) through (4). Secondly, the organization itself must establish that it is not a private foundation. IRC 508(b) provides that, with certain exceptions such as churches, any organization described in IRC 501(c)(3) is presumed to be a private foundation. The presumption of private foundation status, however, may be rebutted by an organization's filing a timely notice and establishing its status as a non-private foundation. Also, a non-exempt charitable trust described in IRC 4947(a)(1), while not subject to the presumption of private foundation status under IRC 508(b), may seek a determination of its foundation status as a supporting organization under IRC 509(a)(3) by following the procedures contained in Rev. Proc. 72-50, 1972-2 C.B. 830.

2. Exceptions to Private Foundation Classification in General

The first of the four exception categories, IRC 509(a)(1), excludes those organizations described in IRC 170(b)(1)(A)(i) through (vi). Such organizations

qualified for increased charitable contributions prior to the Tax Reform Act of 1969. Therefore, this category simply enumerates a class of organizations previously favored. Included in this category are organizations whose activities are inherently public in nature: churches, schools, hospitals, certain medical research organizations, organizations holding property for certain colleges and universities, and certain governmental units. Also included are certain organizations dependent on public support, specifically, those organizations that receive a substantial part of their support in the form of grants or contributions from governmental units or from direct or indirect contributions from the general public.

To the above favored organizations were added two additional types of organizations: publicly supported organizations described in IRC 509(a)(2) and public safety testing organizations described in IRC 509(a)(4). IRC 509(a)(2) includes publicly supported organizations unable to meet the requirements of IRC 170(b)(1)(A)(vi) because of their dependence on receipts from activities directly related to the furtherance of their exempt functions. A museum that is largely dependent on admission fees would fit this description.

Three of the four exceptions, therefore, embrace organizations that have either broadly based public support or engage in an inherently public activity. The organizations encompassed in the IRC 509(a)(3) exception, however, have neither attribute. They are organizations that have the private support normally associated with a private foundation. Moreover, supporting organizations are frequently established by trusts created at death (testamentary) or during life (inter-vivos) to accomplish a specific purpose of the creator. For example, the creator may want to establish a scholarship fund named after a designated person or for the exclusive use of a class of persons such as students who live in a particular area. Instead, IRC 509(a)(3) excludes organizations from private foundation classification by reason of their close relationship to those public charities classified as IRC 509(a)(1) or (a)(2) organizations. (As with IRC 509(a)(1) or (a)(2) organizations, supporting organizations may be foreign or domestic. See. Rev. Rul. 74-229, 1974-1 C.B. 142.)

3. IRC 509(a)(3) - The Statute

The theory supporting the IRC 509(a)(3) exception is that the public charity's control or involvement with the organization will render unlikely the potential for manipulation to private ends present in private foundations. The statute, therefore, requires that the organization meet all three of the following tests:

1. Organizational and Operational Test under IRC 509(a)(3)(A). It must be organized and at all times operated exclusively for the benefit of, to perform the functions of the specified organizations described in IRC 509(a)(1) and (2);
2. Nature of Relationship Test under IRC 509(a)(3)(B). It must be operated, supervised or controlled by or in connection with one or more organizations described in IRC 509(a)(1) and (2); and
3. Lack of Outside Control Test under IRC 509(a)(3)(C). It must not be controlled directly or indirectly by one or more disqualified persons (as defined in IRC 4946) other than foundation managers and other than one or more organizations described in IRC 509(a)(1) or (2).

The statute adds one wrinkle to organizations described in IRC 509(a)(1) or (2). Several membership-based organizations, exempt under IRC 501(c)(4), (c)(5) or (c)(6), have established organizations to conduct their charitable activities. Having created an organization recognized as exempt under IRC 501(c)(3), a membership-based organization may also have the charity avoid private foundation status if its creator could qualify under IRC 509(a)(2) if it were an IRC 501(c)(3) organization.

Overall, these tests seek to define the extent of control or involvement by the IRC 509(a)(1) or (2) "supported" organization and the lack of control or involvement of others. Implementation of these tests is left to the regulations.

4. The Relationship Test in the Regulations in General - Reg. 1.509(a)-4(f), (g), and (i)

Of the three tests, the relationship test of IRC 509(a)(3)(B) is the centerpiece of the statute. As set forth in Reg. 1.509(a)-4(f)(2), there are three permissible relationships: (a) operated, supervised, or controlled by; (b) supervised or controlled in connection with; and (c) operated in connection with one or more publicly supported organizations. Any supporting organization wishing to be classified as an IRC 509(a)(3) organization must fit into one of the above categories. Furthermore, (and this is why the relationship test, while listed beneath the organizational and operational test in both statute and regulations, is the first that must be considered) the particular relationship that the supporting organization has may determine the ease or difficulty it will encounter in meeting the other tests.

The relationships "operated, supervised or controlled by" and "supervised or controlled in connection with" rest, as their names indicate, on a finding of supervision or control. Where such relationships exist, we are dealing with, in the words of Senator Scott (then Senate minority leader) a situation where "(b)y virtue of this complete identity of control...there is in reality only a single entity." (115 Cong. Rec. 37514 (1969)). The "operated in connection with" relationship, on the other hand, is not so concrete; its presence is established by such factors as "responsiveness" and "significant involvement" (Reg. 1.509(a)-4(f)(4)). Stating that "there is in reality only a single entity" is inappropriate here. Perhaps the court in Windsor Foundation v. United States, 77-2 U.S.T.C. 9709 (E. D. Va. 1977), in discussing whether an organization was "operated in connection with," described the situation best by stating "the Internal Revenue Service has drafted fantastically intricate and detailed regulations to thwart the fantastically intricate and detailed efforts of taxpayers to obtain private benefits from foundations while avoiding the imposition of taxes."

a. Operated, supervised or controlled by - Reg. 1.509(a)-4(g)

The relationship where the supporting organization is operated, supervised, or controlled by the supported organization requires a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations - one, the regulations note, that is similar to a parent subsidiary relationship in the corporate area. Such a relationship is established by the fact that a majority of the members of the controlling body of the supporting organization (i.e., its officers, directors, or trustees), are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity or membership of one or more publicly supported organizations. (Reg. 1.509(a)-4(g)(1)(i)).

The supporting organization may establish the "operated, supervised or controlled by" relationship even if it is controlled by one or more publicly supported organizations but operated for the benefit of other publicly supported organizations, provided the purposes of the controlling publicly supported organizations are carried out by benefitting the other publicly supported organizations (Reg. 1.509(a)-4(g)(1)(ii)).

Reg. 1.509(a)-4(g)(1)(iii) gives examples of "operated supervised or controlled by" relationships: (1) a university press operated to perform a university's printing and publishing that is controlled by a Board of Governors

appointed by the university's Board of Trustees; (2) a scientific study council organized under the joint sponsorship of several independent, publicly supported, scientific organizations; and (3) a medical research organization set up by a university that also appoints its trustees, which research organization pays over all its income from its medical research to designated hospitals that allow the university's faculty members to use their research facilities. Rev. Rul. 75-436, 1975-2 C.B. 217, contains yet another example: a trust the sole purpose of which is to grant scholarships to students graduating from the public high schools in a city and which is trustee by the city council, with its funds managed by the city's Treasurer. Finally, Rev. Rul. 81-43, 1981-1 C.B. 350, describes a situation where a community trust (described in Reg. 1.170A-9(e)(11)) qualifies as a supporting organization where it is "operated, supervised or controlled by" a community chest type organization that is a publicly supported organization described in IRC 170(b)(1)(A)(vi) and 509(a)(1).

b. Supervised or controlled in connection with - Reg. 1.509(a)-4(h)

As "organized, supervised, or controlled by" involves a parent subsidiary relationship, "supervised or controlled in connection with" involves a brother-sister relationship. The regulations require common supervision and control by the persons supervising or controlling both the supporting organization and the publicly supported organization. Therefore, control or management of the two organizations must be vested in the same persons. (Reg. 1.509(a)-4(h)(i)).

A significant distinction provided by the regulations between the "supervised and controlled in connection with" relationship and the "operated in connection with" relationship is that an organization will not be considered as being "supervised or controlled in connection with" a publicly supported organization solely by reason of its making payments to the publicly supported organization, even if the publicly supported organization has enforceable rights under state law (Reg. 1.509(a)-4(h)(ii). Also, Example 2, Reg. 1.509(a)-4(h)(iii)).

An example given in the regulations of a "supervised or controlled in connection with" relationship involves a trust created to financially support a church where: all the trustees are members and leaders of the church and office holders in its related institutions; the terms of the trust provide that successor trustees are to be chosen by the remaining trustees and are to be members of the church; and, the trustees represent that any successor trustees will also be church leaders and office holders (Example 3, Reg. 1.509(a)-4(h)(iii)).

c. Operated in connection with - Reg. 1.509(a)-4(i)

The "operated in connection with" relationship rests upon findings of responsiveness to the needs of the publicly supported organization and an integral or significant involvement in the affairs of the publicly supported organization. This relationship is satisfied where the supporting organization meets both the "responsiveness" and "integral part" tests.

1. The responsiveness test - Reg. 1.509(a)-4(ii)

The responsiveness test requires compliance with one of two alternative subparts, with additional facts and circumstances to be taken into account in the case of a relationship that antedates November 20, 1970. (The special facts and circumstances are those which evidence an historic and continuing relationship. (See Reg. 1.509(a)-4(i)(1)(ii)).

The first responsiveness test is set forth in Reg. 1.509(a)-4(i)(2)(ii) and is quite direct. It requires the supporting organization to demonstrate that one of the following arrangements exists: (a) one or more of its officers, directors, or trustees are elected or appointed by the officers, directors, trustees or membership of the publicly supported organization; (b) one or more of its officers, directors, trustees, or important office holders are also members of the governing body of the publicly supported organization; or (c) its officers, directors or trustees maintain a close and continuing relationship with the officers, directors, or trustees of the publicly supported organization. Once the arrangement is shown, the organization faces an additional hurdle: it must demonstrate that by reason of such arrangement, the officers, directors, or trustees of the publicly supported organization have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making them, and in otherwise directing the use of its income or assets. Therefore, where there is a working relationship between the representatives of a publicly supported organization and the trustees of a trust established to provide support, but the working relationship involves only the selection of grantees, the responsiveness test is not met because the publicly supported organization does not have a significant voice in directing the use of the supporting organization's income or assets (Rev. Rul. 75-437, 1975-2 C.B. 219).

The alternative responsiveness test, set forth in Reg. 1.509(a)-4(i)(2)(iii), may be more quickly summarized, but has been the subject of more controversy. It requires that the supporting organization be a charitable trust under state law; that each specified publicly supported organization be a beneficiary under the

charitable trust's governing instrument; and, that the beneficiary organization have the power to enforce the trust and compel an accounting under state law.

Controversy has centered around the specified or "named beneficiary" requirement. The Service's position is that the term requires that each publicly supported organization be named in the trust instrument and be the immediate recipient of the trust's income. Therefore, where the governing instrument requires that the trust's income be used to provide tuition for needy students requiring assistance in obtaining an education in engineering at a particular college, there is no publicly supported organization that is a named beneficiary because the college is not the immediate recipient of the trust's income. Likewise, where the governing instrument requires that the income from the trust be used to "finance or aid in financing the education of a pupil, or pupils selected from the Winterset Community High School in Winterset, Iowa," the Winterset Community School in Winterset, Iowa, is not the named beneficiary, but is simply descriptive of the class of students who are to receive financial aid. In this latter case, however, Nellie Callahan Scholarship Fund v. Commissioner, 73 T.C. 626 (1980), the court held that the named beneficiary requirement was satisfied, finding that under the petitioner's governing instrument, it was clear that the municipality, of which Winterset Community High School is an integral part, was the beneficiary organization. (The Service does not acquiesce in this decision. See 1980-2 C.B. 2.)

The final requirement is that the beneficiary organization have the power to enforce the trust and compel an accounting. In cases where there are named beneficiaries receiving fixed shares of the trust income, it will be assumed that the beneficiary organizations have the power, under state law, to enforce the trust and compel an accounting. In all other cases, the supporting organization must produce authority under state law that the publicly supported organizations have such powers.

2. The Integral Part Test - Reg. 1.509(a)-4(i)(3)

The concept of "significant involvement" is implemented by the integral part test. Like the responsiveness test, the integral part test consists of two alternative subparts, with additional rules concerning older organizations and situations where the size of the publicly supported organization has increased.

Under the first integral part test (Reg. 1.509(a)-4(i)(3)(ii)), the activities engaged in for or on behalf of the publicly supported organization are activities that perform the functions of, or carry out the purposes of, such organizations, and

these activities, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves. This subpart only applies in situations where the supporting organization actually engages in activities that benefit the supported organizations (e.g., performing publishing and printing functions for a college), as opposed to simply making grants to support the publicly supported organizations.

The second subpart, referred to here for convenience as the "attentiveness test," (Reg. 1.509(a)-4(i)(3)(iii)), has three basic requirements: (1) the supporting organization must pay substantially all of its income to or for the use of one or more publicly supported organizations, (Rev. Rul. 76-208, 1976-2 C.B. 168, holds that "substantially all," in this context means at least 85 percent of the organization's income); (2) the amount of support received by one or more of such publicly supported organizations must be sufficient to insure the attentiveness of such organizations to the operations of the supporting organization; and, (3) a substantial amount of the total support of the organization must go to those publicly supported organizations that meet the attentiveness requirement. (This last condition was inserted to guarantee that the organization most significantly involved with the supporting organization is not a relatively minor character in the scheme of things.)

Of the three requirements, the second, the showing of the requisite attentiveness, is obviously the most difficult. Reg. 1.509(a)-4(i)(3)(iii) sets forth in subdivisions (a), (b), and (d) three ways of meeting the attentiveness test. Each of these is discussed below.

A. Reg. 1.509(a)-4(i)(3)(iii)(a) involves situations where the amount of support provided is deemed sufficient to insure the publicly supported organization's attentiveness. Under this subdivision attentiveness is measured by comparing the amount of support the organization provides to total support. "Total support" refers to the publicly supported organization's total support unless the supported organization is a university, hospital, church, etc. and the support is provided to a particular school or department of the larger entity. (In such a case, the support provided may be compared with the total support of the department or school rather than the total support of the entire organization.) As a rule of thumb, a grant of less than 10 percent of total support would, in the usual case, be insufficient to insure attentiveness. One final note: by its very terms,

subdivision (a) applies to grant making programs rather than to organizations that engage in their own independent program. Therefore, the subdivision is inapplicable to organizations that engage in their own independent programs.

- B. Reg. 1.509(a)-4(i)(3)(iii)(b) provides that a supporting organization can meet the attentiveness requirement, even if it does not provide a sufficient amount of the beneficiary's total support, if its support is earmarked for a particular program or activity of the publicly supported beneficiary organization. The test is whether the publicly supported organization will be attentive to the operations of the supporting organization in order to avoid the interruption of the particular earmarked function or activity. Reg. 1.509(a)-4(i)(3)(iii)(c) furnishes two examples: an organization that underwrites a chamber music series at a museum, and an organization that endows a chair at a law school. In these examples, there are three common factors: (a) the supporting organization pays over all its income; (b) the supporting organization provides all the funds; and (c) the expense of conducting the program is substantial.
- C. Reg. 1.509(a)-4(i)(3)(iii)(d) is a facts and circumstances provision. It notes that "all pertinent factors ...will be considered in determining whether the amount of support received by a publicly supported beneficiary organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization. Factors mentioned include the number of beneficiaries, length and nature of the relationship of the organizations, the purpose to which the funds are put and "acceptable evidence of actual attentiveness," such as a requirement that the supporting organization furnish its financial statements so that the beneficiary organization can assure itself of the investment and operational practices of the supporting organization. This facts and circumstances provision neither states, nor implies, that any of the above factors will be determinative. However, it is fair to assume certain combinations of facts and circumstances will qualify. Two examples: (1) the supporting organization has provided \$ 100,000 annually to a city museum over a number of years. The museum is the only beneficiary of the supporting organization

and the amount provided represents substantially all of the supporting organization's income. The supporting organization is the only nongovernmental organization that supports the museum. Also, the supporting organization furnishes copies of its annual reports to the director of the museum who has furnished a statement that these reports are reviewed upon receipt. Finally, the museum director is authorized to approve or veto expenditures by the supporting organization. The program cannot qualify under subdivision (a) because the support is minimal when compared to the museum's total support. It may however qualify under subdivision (d) because of the continuing nature of the relationship and the size of the grant; (2) an organization earmarks income to support a substantial program of a publicly supported organization. The funds constitute 50 percent of the program's total support, and the organizations have exchanged financial reports and regularly corresponded regarding the details of the program. The combination of the earmarking of funds, the size of the grant, the percentage of support, and the frequency and nature of the correspondence, would meet the requirements of subsection (d). As a final note, Reg. 1.509(a)-4(i)(3)(e) provides that a beneficiary organization's enforceable rights under state law will not satisfy the integral part test.

As previously noted, there are special integral part test rules for two special situations. The first involves an organization that meets the integral part test for a specified number of years, but can no longer do so under the general rules because the supported organization has expanded to the extent that the support is no longer sufficiently substantial. In such a case the integral part test is deemed satisfied if: (a) the test was satisfied for a five year period; (b) the failure to satisfy the test for the current taxable year is attributable to the fact that the provided support is no longer sufficiently substantial; and, (c) between the five year period and the taxable year there has been an historic and continuing relationship between the two organizations (Reg. 1.509(a)-4(i)(1)(iii)).

The second special rule, the "transitional rule" of Reg. 1.509(a)-4(i)(4), involves older trusts. Under this rule, the trust will be deemed to meet the integral part test if, for taxable years beginning after October 16, 1972, written annual reports are provided to each public charity and the trust met all of the five following tests on November 20, 1970, and all years thereafter: (a) all its interests

are devoted to the purposes set forth in IRC 170(c)(1) or (2)(b), and a charitable deduction was allowed or allowable with respect to such interests; (b) the trust was created before November 20, 1970, and did not receive any gift, grant, contribution or bequest after that date; (c) the trust is required to distribute all of its net income currently to the designated public charities; (d) the trustee has no discretion to vary the amounts payable to any beneficiary; and, (e) none of the trustees would be treated as disqualified persons (except by reason of being foundation managers) with respect to the trust if the trust were a private foundation.

5. The Organizational and Operational Tests

a. The Organizational Test - Regs. 1.509(a)-4(c) and (d)

Under Reg. 1.509(a)-4(c)(1), an organization's governing instrument must meet the following requirements:

- (i) limit the purposes of the organization to one or more of the purposes set forth in IRC 509(a)(3)(A);
- (ii) not expressly empower the organization to engage in activities which are not in furtherance of such purposes;
- (iii) state the specified publicly supported organizations on whose behalf the organization is to be operated; and
- (iv) do not expressly empower the organization to support or benefit any organization other than the specified publicly supported organizations.

An organization whose relationship is "operated, supervised, or controlled by" or "supervised or controlled in connection with" should not have much difficulty meeting the organizational requirements. With respect to purposes, it meets this requirement if the purposes set forth in its governing instrument are similar to, but no broader than, the purposes set forth in the articles of its controlling IRC 509(a)(1) or (a)(2) organization. Organizations that are operated, supervised, or controlled by or supervised or controlled in connection with a publicly supported IRC 501(c)(4), (5), or (6) organization deemed to be an IRC 509(a)(1) or (2) organization for purposes of IRC 509(a)(3), merely must have articles that require it to carry on charitable activities within the meaning of IRC

170(c)(2). For a discussion of the involvement of a publicly supported non-501(c)(3) organization, see Rev. Rul. 76-401, 1976-2 C.B. 175.

With respect to specifying publicly supported organizations in the governing instrument, an organization having either the "operated, supervised or controlled by" or the "supervised or controlled in connection with" relationship satisfies this requirement even if it designates the supported organizations by class or purpose rather than by name; e.g., institutions of higher learning in the State of X, - see the examples in Reg. 1.509(a)-4(d)(2)(iii) and Rev. Rul. 81-43, 1981-1 C.B. 350. Secondly, in such cases, it is permissible for the supporting organization's governing instrument to permit: (1) the substitution of one publicly supported organization within the same class for another publicly supported organization within the same class or a different class designated in the articles; (2) the supporting organization to operate for the benefit of new or additional publicly supported organizations of the same class designated in the articles; or (3) the supporting organization to vary the amount of its support among different publicly supported organizations within the class or classes of organizations designated in the articles.

Therefore, a supporting organization that is "operated supervised or controlled by" or "supervised or controlled in connection with" will, by meeting such minimal requirements, satisfy the organizational test unless it expressly empowers itself to engage in activities not in furtherance of IRC 509(a)(3)(A) purposes, or expressly empowers itself to support or benefit a non-publicly supported organization.

Where a supporting organization is "operated in connection with" publicly supported organizations, the organizational test may pose severe problems. First, with respect to purposes, Reg. 1.509(a)-4(c)(2) provides that the articles of the supporting organization must state that it is formed "for the benefit of," "to carry out the functions of," or "to carry out the purposes of" one or more publicly supported organizations. Although the regulation does not require that such exact words be used, there must be at least some statement committing the supporting organization to support or benefit the publicly supported organizations. Therefore, a statement in a trust instrument that the trust income is to be used "for the purpose of paying for...the education...at Yale College of such graduates of Duxbury, Massachusetts, High School or bona fide residents of Duxbury" would fail to satisfy the requirement because it fails to include a statement that the trust was created to benefit the publicly supported organization (Yale); rather the instrument states that the purpose of the trust is to benefit students. In the case where the

above provision appeared, however, (Goodspeed Scholarship Fund v. Commissioner, 70 T.C. 515 (1978)), the court ruled otherwise and stated: "We see no use in requiring language more specific than that which Mrs. Goodspeed used." The Service does not acquiesce in this decision (1981-1 C.B. 2).

Compliance with the organizational test necessitates that in addition to (1) the purposes requirement, (2) the requirement that it not be expressly empowered to engage in activities not in furtherance of such purposes, and (3) the requirement that it not be expressly empowered to support or benefit any organization other than specified publicly supported organizations, a supporting organization with an "operated in connection with" relationship to a publicly supported organization must state, by name, the specified publicly supported organizations on whose behalf the organization is to be operated. However, in situations where there has been an historic relationship between the supporting organization and the publicly supported organization and where, by reason of such relationship, a substantial identity of interest has been developed between the organizations, the supporting organizations need be only as specific as organizations "operated supervised or controlled by," or "supervised or controlled in connection with." See Reg. 1.509(a)-4(d)(2)(iv).

There are some wrinkles in the manner in which the publicly supported organization may be designated. If the supporting organization does designate the specified publicly supported organization by name, an organization will not fail to meet the organizational test because its articles permit the substitution of a publicly supported organization, designated by class or purpose rather than by name, to be submitted for the publicly supported organizations designated by name in its articles, but only if such substitution is conditioned upon an event beyond the control of the supporting organization, such as loss of exemption, substantial failure or abandonment of operations, or dissolution of the publicly supported organizations or organization designated in the articles. Whether a substitution provision is conditioned upon an event or events beyond the control of the supporting organization may be at issue in a particular case. In Quarrie Charitable Fund v. Commissioner, 70 T.C. 182 (1978), the trust instrument contained the following provision regarding substitution of beneficiaries:

In the event that at some future date, any of the aforesaid charitable uses in the judgment of the Northern Trust Company shall become unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public, the income otherwise to be devoted to such use shall be distributed

to such charitable, scientific, education or religious corporations, trusts, funds, or foundations as The Northern Trust Company may select to be used for their general purposes.

The court concluded that the nature of the events combined with the trustee's exercise of judgment brings these events within the trustee's control for all practical purposes. Therefore, due to the above provision, the organization failed to meet the organizational test of IRC 509(a)(3)(A) and Reg. 1.509(a)-4(d).

Failure to meet the organizational test also will not occur solely because the supporting organization's articles permit it to operate for the benefit of a non-publicly supported beneficiary organization which is designated by class or purpose, but only if a publicly supported organization is currently being supported and the possibility of operating for the benefit of other than a publicly supported organization is conditioned on events outside the publicly supported organization's control. If an organization that is not publicly supported eventually becomes the beneficiary, the supporting organization will fail the operational test of Reg. 1.509(a)-4(e)(1), and, therefore, would no longer be described in IRC 509(a)(3), but it would not fail the organizational test. Conversely, if the supporting organization's articles permit it to operate for the benefit of a non-publicly supported beneficiary organization that is designated by name, the publicly supported organizations will not fail the organizational test but only if a publicly supported organization is currently being supported and the possibility of operating for the benefit of other than a publicly supported organization is a remote contingency. However, if an organization that is not publicly supported eventually becomes the beneficiary, the supporting organization will fail both the organizational and operational tests. The difference in result depends on whether the non-publicly supported organization is specifically named. See Regs. 1.509(a)-4(c)(3) and 1.509(a)-4(d)(4).

b. The Operational Test - Reg. 1.509(a)-4(e)

The operational test concerns itself with permissible beneficiaries and permissible activities, and provides that a supporting organization will be regarded as "operated exclusively" to support one or more specified organizations only if it engages in activities that support or benefit the publicly supported organizations. Such activities may include making payments to or for the use of or providing services or facilities to individual members of the charitable class benefitted by the specified publicly supported organizations. Payments may be made to

organizations other than the specified publicly supported organization only under the following circumstance: a) if the payment constitutes a grant to an individual who is a member of the charitable class benefitted by the specified publicly supported organization rather than a grant to the organization receiving it - here the applicable rules are set forth in Reg. 53.4945-4(a)(4); b) the payment is made to an organization that is operated, supervised or controlled by, supervised or controlled in connection with, or operated in connection with the publicly supported organization, or, c) the payment is made to an organization described in section IRC 511(a)(2)(B) (colleges and universities that are government agencies or instrumentalities or are owned and operated by government instrumentalities). See Reg. 1.509(a)-4(e)(1).

Reg. 1.509(a)-4(e)(2) notes that a supporting organization is not required to pay over its income to supporting organizations, but may carry on its own independent programs designed to support or benefit the specified publicly supported organization, as long as all such support is limited to permissible beneficiaries - those listed in items (a) through (c) of the preceding paragraph. Reg. 1.509(a)-4(e)(3) furnishes examples of independent programs that are permissible. These include an alumni organization that uses its income to conduct a program of educational activities for the university's alumni faculty and students, and an organization formed and supported by a church to conduct educational lectures on religious subjects. Supporting organizations may also engage in fund raising activities, such as solicitations, fund raising dinners, and unrelated trade or business to raise funds for the publicly supported organizations or their permissible beneficiaries.

6. The Disqualified Person Control Test

Under IRC 509(a)(3)(C), a supporting organization may not be controlled, directly or indirectly by disqualified persons. Because of the structure of the relationship test, the question of control arises most often with organizations that purport to be "operated in connection with" publicly supported organizations.

It is necessary to look to whether disqualified persons may, by aggregating their votes or positions of authority, require the supporting organization to engage, or decline to engage, in an act that significantly affects the operations of the supporting organization. Reg. 1.509(a)-4(j)(1) enunciates the general rule: control will be found where the disqualified persons have either 50 percent of the voting power or a veto power over the supporting organization's activities. The 50 percent test is rebutted, however, by a showing that, in fact, some other person or group

has control, e.g., in the case of a religious organization operated by a church, the fact that the majority of the organization's governing body is composed of lay persons who are substantial contributors (as defined in IRC 4946) to the organization will not disqualify the organization under IRC 509(a)(3)(C) if a representative of the church, such as a bishop or other official, has control over the policies and decisions of the organization - see Reg. 1.509(a)-4(j)(2). For purposes of the control test, a foundation manager who is a disqualified person for some other independent reasons, such as being a substantial contributor, will be treated as a disqualified person even if appointed or designated as a foundation manager by the publicly supported beneficiary organization. IRC 509(a)(3)(C) not only forbids the type of control discussed above, "direct control," it also prohibits "indirect control." Therefore, Reg. 1.509(a)-4(j)(1) provides that all pertinent facts and circumstances will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization, including the nature, diversity, and income yield of the organization's holdings, the length of time particular stocks, securities, and other assets are retained, and its manner of exercising its voting rights with respect to stocks in which members of its governing body have some interest.

In Rev. Rul. 80-207, 1980-2 C.B. 193, indirect control is found, despite the absence of a veto power, where the organization's four member governing body is composed as follows: one disqualified person (a substantial contributor), two employees of a corporation, also a disqualified person, in which more than 35 percent of the voting power is owned by the substantial contributor, and one representative of the publicly supported organization. The Rev. Rul. notes that one circumstance to be considered is whether a disqualified person is in a position to influence members of the organization's governing body who are not themselves disqualified persons, and, therefore, the two directors' positions as employees of the disqualified person (the corporation) had to be taken into account. As a result, the majority of the governing body was seen to be a disqualified person, and the conclusion was that indirect control by disqualified persons existed. In Rev. Rul. 80-305, 1980-2 C.B. 71, a trust that would otherwise have qualified as a supporting organization of a community trust could not qualify because of the right of the donors to designate recipients. (In this case, the trust was held to qualify as an organization described in IRC 170(b)(1)(D)(iii). In addition, the trust would not have qualified as a component part of the community trust under Reg. 1.170(a)-9(e)(11).)

7. Conclusion

The area of supporting organizations is one that must be taken on a step-by-step basis, since it involves satisfaction of tests and subtests. Nevertheless, there is a pattern of control or involvement by the publicly supported organizations from which emerge those organizations that fit the supporting organization definition.

[FLOW CHART not shown here]