

Private foundation; charitable trust granting scholarships. An exempt charitable trust, established solely to provide college scholarships to county high school graduates, that is trustee by an independent bank trustee is a private foundation and not a supporting organization within the meaning of section 509(a)(3) of the Code.

Advice has been requested whether the charitable trust described below is a supporting organization within the meaning of section 509(a)(3) of the Internal Revenue Code of 1954 and thus not a private foundation.

An individual recently established the charitable trust which has been recognized as exempt from Federal income tax under section 501(c)(3) of the Code. The sole purpose of the trust is to provide college scholarships to graduates of the high schools in a particular county. Recipients of scholarships are selected by a committee composed of the superintendent of schools of the county, the superintendent of schools of one city within the county, and a third member selected by the two superintendents. The selection committee has no authority with respect to the administration and operation of the trust. This responsibility is vested in a bank that has been designated as trustee of the trust.

The income of the trust is derived from interest and dividends; expenditures are for scholarships and administrative expenses.

Those high schools in the county which are separately incorporated and which have only educational purposes are organizations described in section 170(b)(1)(A)(ii) of the Code. Those which are not separately incorporated but are operated by either the county or one of the cities within the county are not section 170(b)(1)(A)(ii) organizations; however, the governmental units of which they are a part are section 170(b)(1)(A)(v) organizations. Thus, all of the high schools in the county or the governmental units of which they are a part are organizations described in sections 170(b)(1)(A) and 509(a)(1).

Section 509(a)(3) of the Code excludes from the definition of a 'private foundation' an organization which--

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in paragraph (1) or (2),

(B) is operated, supervised, or controlled by or in connection with one or more organizations, described in paragraph (1) or (2) and

(C) is not controlled directly or indirectly by one or more

disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2).

Section 1.509(a)-4(c)(1) of the Income Tax Regulations provides that an organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) of the Code only if its articles of organization:

(i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);

(ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes set forth in subdivision (1) of this subparagraph;

(iii) State the specified publicly supported organizations on whose behalf such organization is to be operated within the meaning of paragraph (d) of this section); and

(iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

Under section 1.509(a)-4(c)(2) of the regulations, the supporting organization's governing instrument must state that the organization is formed for the benefit of, to perform a function of, or to carry out a purpose of an organization described in section 509(a)(1) or (2) of the Code.

The trust in the instant case does not satisfy this requirement of the 'organizational test,' because the trust instrument does not contain the requisite statement of purpose. Since the trust is not 'operated, supervised, or controlled by' or 'supervised or controlled in connection with' the publicly supported schools and governmental units, the fact that the educational purposes of the trust are consistent with those of the schools and governmental units is not sufficient to satisfy the organizational test.

Under section 1.509(a)-4(d)(2) of the regulations, if the supporting organization is neither 'operated, supervised, or controlled by' nor 'supervised or controlled in connection with' a publicly supported organization, then the 'specified' publicly supported organization must be designated by name in the supporting organization's articles unless there has been an historic and continuing relationship between the supporting organization and the supported organization and by reason of such relationship there has developed a substantial identity of interests between such organizations.

Because the trust in the instant case does not bear one of the above prescribed relationships to the publicly supported

schools and governmental units, the failure of the trust instrument to name the supported organizations prevents it from satisfying this requirement of the organizational test.

Since the trust does not meet either of the two basic requirements of the organizational test, it is not an organization described in section 509(a)(3) of the Code.

Section 1.509(a)-4(e)(1) of the regulations provides that a supporting organization will be regarded as 'operated exclusively' to support one or more specified publicly supported organizations only if it engages solely in activities which support or benefit the specified publicly supported organizations. This may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organizations.

In granting scholarships to the graduates of the high schools in the county, the trust is benefiting members of the charitable class benefited by the schools and governmental units which operate the schools. See Example (1) of section 1.509(a)-4(e)(3) of the regulations. Thus, aside from the fact that the schools and governmental units are not properly specified, the trust meets the requirements of the 'operational test.'

Section 1.509(a)-4(f)(1) of the regulations provides that in order to meet the requirements of section 509(a)(3) of the Code, an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. This test is met if the organization is: (1) 'operated, supervised, or controlled by' one or more publicly supported organizations (section 1.509(a)-4(g)); (2) 'supervised or controlled in connection with' one or more publicly supported organizations (section 1.509(a)-4(h)); or (3) 'operated in connection with' one or more publicly supported organizations (section 1.509(a)-4(i)).

Because of the complete independence of the trustee in the instant case, the trust is neither 'operated, supervised, or controlled by' nor 'supervised or controlled in connection with' the publicly supported schools and governmental units.

To be considered as 'operated in connection with' one or more section 509(a)(1) or (2) organizations, an organization must meet both the 'responsiveness test' of section 1.509(a)-4(i)(2) of the regulations and the 'integral part test' of section 1.509(a)-4(i)(3).

With exceptions not here relevant, the responsiveness test is satisfied only if the organization meets the requirements of either section 1.509(a)-4(i)(2)(ii) or (iii) of the regulations. The first of these tests requires that:

- (a) One or more officers, directors, or trustees of the

supporting organization are elected or appointed by the officers, directors, trustees, or membership of the publicly supported organizations;

(b) One or more members of the governing bodies of the publicly supported organizations are also officers, directors, or trustees of, or hold other important offices in, the supporting organization; or

(c) The officers, directors, or trustees of the supporting organization maintain a close and continuous working relationship with the officers, directors, or trustees of the publicly supported organizations; and

(d) By reason of (a), (b) or (c) of this subdivision, the officers, directors, or trustees of the publicly supported organizations have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making them, and the selection of recipients by such supporting organization, and in otherwise directing the use of the income or assets of such supporting organization.

Because the trustee of the trust is completely independent of the publicly supported schools and governmental units, requirements (a) and (b) are not satisfied. Requirement (c) may be satisfied because of the working relationship between the representatives of the publicly supported organizations on the selection committee and the trustee. However, requirement (d) is not satisfied because the publicly supported organizations do not have a significant voice in the investment policies of the trust or the timing and making of grants. The selection committee's authority extends only to the selection of grant recipients.

The alternative method of satisfying the responsiveness test provided by section 1.509(a)-4(i)(2)(iii) of the regulations, requires that:

(a) The supporting organization is a charitable trust under State law;

(b) Each specified publicly supported organization is a named beneficiary under such charitable trust's governing instrument; and

(c) The beneficiary organization has the power to enforce the trust and compel an accounting under State law.

Although the trust in the instant case satisfies requirement (a), it does not satisfy either (b) or (c). The publicly supported organizations are not named beneficiaries and, under the applicable state law, there is no authority supporting the right of organizations such as these to enforce the trust or compel an accounting.

Under section 1.509(a)-4(i)(3) of the regulations, an organization will satisfy the integral part test (with exceptions not here relevant) only if it maintains a significant involvement in the operations of one or more publicly supported organizations and these organizations are dependent upon the supporting organization for the type of support which it provides. The integral part test will not be satisfied unless: (1) the activities engaged in for or on behalf of the publicly supported organizations are ones which, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves; or (2) the supporting organization makes payments of substantially all of its income to or for the use of one or more publicly supported organizations and the amount received by one or more of the publicly supported organizations is sufficient to insure their attentiveness to the operations of the supporting organization.

The first of these tests is not met in the instant case because the granting of scholarships is not an activity which would normally be engaged in by the publicly supported schools and governmental units. Cessation of the operation of this trust would not cause the schools and governmental units to assume the trust's scholarship program.

The second test is not applicable because the trust is not making grants to or for the use of a school or governmental unit, but is carrying on its own independent scholarship program. Thus, the integral part test of section 1.509(a)-4(i)(3) of the regulations is not satisfied.

Because neither the responsiveness test nor the integral part test is satisfied, the trust is not 'operated in connection with' the publicly supported schools and governmental units.

In summary, the trust is not an organization described in section 509(a)(3) of the Code because it does not meet the organizational test of section 1.509(a)-4(c) and (d) of the regulations and because it is not 'operated, supervised, or controlled by,' 'supervised or controlled in connection with' or 'operated in connection with' one or more publicly supported organizations as required by section 1.509(a)-4(f) of the regulations.

Accordingly, the trust is not a supporting organization within the meaning of section 509(a)(3) of the Code and is a private foundation.