RETURN TO TABLE OF CONTENTS

PUBLIC CHARITIES, PRIVATE FOUNDATIONS, AND SUPPORTING ORGANIZATIONS FOR THE NON-EXEMPT ORGANIZATIONS SPECIALIST

Part I: Public Charities and Private Foundations - A Statutory Roadmap

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I. Introduction.

A rare bright spot to emerge in the midst of the worst recession in decades is an increased interest in benevolent, altruistic enterprises, with a resulting increase in the establishment of tax-exempt nonprofit corporations. The deceptively simple nonprofit corporation process can quickly escalate into expensive and time-consuming headaches during the tax-exempt application process status via Form 1023 (Application for Recognition of Exemption from Federal Income Tax) if prepared by one inexperienced in the process. In light of the media and regulatory focus on nonprofit organizations, this two-part Article attempts to assist the tax practitioner by reviewing essential formation issues for the nonprofit organization, tax-exempt under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended ("Code"), and hopefully unshackle altruism from the burdens of Code complexity. Part I will examine the essential decision made when creating a new Section 501(c)(3) organization – whether the entity will be a public charity or private foundation – and reviews the exhaustively complex subcategories of these types of Section 501(c)(3) organizations. The second Part, to be published later this year, will discuss the new "supporting organization" rules passed under the Pension Protection Act of 2006 ("PPA '06") and decipher the Type I-II-III distinctions now relevant to major corporate and individual donors.

II. All Section 501(c)(3) Organizations Must Address Public Charity Versus Private Foundation Distinction.

The statutory framework governing Section 501(c)(3) organizations seems simple enough – Section 501(c)(3) simply identifies the tax-exempt charitable organization as one which is:

> *organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.*[2]

Yet once the basic Section 501(c)(3) statute is satisfied – the organizational and operational tests, the prohibition against private inurement and public benefit, the prohibition against political campaign activities and such as provided therein – the practitioner must still refer to the less-familiar Section 508(a)("Special rules for 501(c)(3) organizations"), which reminds us that (i) the hopeful Section 501(c)(3) organization *must* apply for recognition of exemption (unlike other tax-exempt organizations); and (ii) all Section 501(c)(3) organizations are *automatically private foundations* unless the IRS is notified otherwise in their required application for recognition of exemption.[3]

The private foundation rules confuse many in part because the term "private foundation" is a specific tax term as opposed to the generic "charitable foundation" term, and in part because the specific tax statutes themselves are migraine-inducing by lacking some essential (i.e. helpful) cross-referencing, or include cross-referencing which nobody really wants to track down.[4] Rather than containing a useful mention of private foundation rules within Section 501(c)(3) (so tax lawyers in more profitable practices might actually notice), the Code requires tax lawyers to magically discover Section 508 ("Special Rules with Respect to Section 501(c)(3) Organizations) and Section 509 ("Private Foundation Defined") on their own.[5] These sections remind us that (1) all Section 501(c)(3) organizations are automatically "private foundations" unless the IRS is told and convinced otherwise; and (2) Section 509 gets its jollies by defining "private foundation" as a bunch of things they are actually not (which is about as useful as telling a grocer an apple is anything not an orange, a pear, a cantaloupe, or a mangosteen).

A. What's a Private Foundation?

The client-understandable answer to this question is that a "private foundation" is a Section 501(c)(3) organization that relies upon a handful of wealthy donors for its money and can afford to navigate the plethora of legal restrictions and filing requirements therewith. Ideally, the creators and governing body of a private foundation will actually be advised of the consequences of being one because the consequences, as discussed in Section III of this Article, are kind of annoying. The long and tax-oriented answer to "What's a private foundation?" requires parsing Section 509(a), which, while titled "Private Foundation Defined," might better be titled "How to Get Out of Private Foundation Status By Reviewing the Most Excruciatingly Complex Code Provisions Ever Devised."6

1. It's Not a Private Foundation if it Is Described in Section 509(a)(1).

The first categories (yes, there are categories) of Section 501(c)(3) organization that automatically avoid private foundation classification, all described under Section 509(a)(1), are actually those which are listed in clauses (i) through (vi) of Section 170(b)(1)(A).[7] Tax nerds call these Section 501(c)(3) organizations "Section 509(a)(1) organizations," which is pretty annoying because all Section 509(a)(1) does is cross-refer to Section 170(b)(1)(A). What is Section 170(b)(1)(A)? Section 170(b)(1)(A) deals with the actual charitable deduction rules that authorize charitable contributions to certain specifically-defined entities (obviously it would be too easy to have these rules in the rules governing Section 501(c)(3) organizations), and, depending on the organization's classification, also limits the actual charitable contribution deduction to 50 percent or 30 percent of the donor's "contribution base," which is defined as the donor's adjusted gross income ("AGI").[8] So, Section 170(b)(1)(A) lists what we can call "50 percent deductibility charities;" Section(b)(1)(B) provides the rule for "30 percent deductibility charities," which include most private foundations.

Types of Section 501(c)(3) organizations that "get out of private foundation jail" under Section 170(b)(1)(A) include:

(i) *churches;*[9]

(ii) *educational institutions* with regular faculties and curriculum and regular enrollment;[10]

(iii) *hospitals or medical education or research institutions* (provided certain parameters are met);[11]

(iv) Section 501(c)(3) organizations that both meet a "substantial support test" by receiving substantial support from Section 170(c)(1) governmental units or the general public and makes distributions to educational institutions owned or operated by a governmental unit or agency thereof (i.e. *public university foundations*);[12]

(v) governmental units (as specified in Section 170(c)(1);[13] and

(vi) a Section 501(c)(3) organization which receives a "substantial part of its support," "exclusive of income" received in its exercise or performance of activities, from a governmental unit or from direct or indirect contributions from the general public; called *publicly supported organizations*.[14]

This last organization, the publicly supported organization classification, creates a lot of confusion (okay, *more* confusion if you actually got this far). The primary reason for such confusion is the annoying fact that under the Code, there are actually *two* types of "publicly supported organizations." Section 170(b)(1)(A)(vi) is the first type (which is discussed right here), and Section 509(a)(2) is the other type (and will be discussed in more detail later). The main difference is that under Section 170(b)(1)(A)(vi), support from performance of activities (such as performance of medical services for the indigent, performance of plays, admission fees, etc.) is NOT included.[15] In contrast, under Section 509(a)(2), a publicly supported organization may include in the income from exempt activities in satisfying the tests.[16] Section 170(b)(1)(A)(vi) was effective for tax years after December 31, 1963; Section 509(a)(2) was passed in 1969 to extend the same benefits to organizations in which receipts from performance of the exempt function was a major source of revenue and the public support test for Section 170(b)(1)(A)(vi) could not be met.[17]

Under both types of publicly supported organizations, the support test is met if the publicly supported organization either receives at least 1/3rd of its support from governmental or general public sources; however, Section 170(b)(1)(A)(vi) publicly supported organizations may in the alternative meet a facts and circumstances test that is satisfied if the hopeful organization normally receives at least 10 percent of all its support from government or public sources, has a bona fide program for solicitation of funds from the government or public sources, and (by looking at all facts and circumstances) the activities are actually going to appeal to persons with broad common interests or purposes.[18] Meeting these tests can be difficult if the funds primarily come from a few key sources with no real fundraising or grant solicitations.

Organizations described in clauses (vii) and (viii) of Section 170(b)(1)(A) are purposely left out as automatic non-private foundations.[19] Under clause (vii), such organizations qualify for some, but not all, non-private foundation advantages separately (though they are still private foundations, technically). Section 170(b)(1)(A)(vii) cross-refers to recently amended Section 170(b)(1)(F) (which was moved to (F) under PPA '06 to make room for new (E), now dealing with qualified conservation contributions). Clause (vii) therefore describes three types of private foundations that are "*not so-bad*" private foundations. Thus, Section 170(b)(1)(F) covers *private operating foundations* (which are subject to separate rules that give them the same advantages of private foundations), *conduit foundations*, and *common fund foundations*. Under Clause (viii), Section 509(a)(2) and (3) organizations are covered and these are also not private foundations. First covered will be clause (vii) "not so bad" private foundations.

A *private operating foundation* actively conducts its own tax-exempt activities rather than simply distributing funds to other organizations. The cross-referencing fun continues as the meat of the definition of a "private operating foundation" is found not in Section 170 or in Section 509, but in Section 4942(j)("Taxes on Failure to Distribute Income; Other Definitions") and the accompanying Treasury regulations. Part of the reason the definition is here is because private operating foundations aren't subject to the Section 4942 taxes on failure to distribute its income[20] and also get the benefits of "50 percent deductibility charities."[21] To understand private operating foundations, the tax practitioner has to leave the safe confines of Section 170 and jump to Section 4942. A private operating foundation must satisfy (i) an income test and (ii) either an assets test, an endowment test, or a support test for its current tax year.[22] Through these tests, the IRS ensures the private operating foundation directly and actively carries out its exempt purposes through its own programs.

(i) The *income test* for a private operating foundation is met if it spends substantially all of the lesser of its adjusted net income or its minimum investment return (generally, 5 percent of the fair market value of all assets less acquisition indebtedness) directly for the active conduct of the activities or purpose for which it was organized and operated. "Substantially all" means 85 percent or more of either adjusted net income or minimum investment return.[23]

(ii) The *assets test* is met if the private operating foundation devotes substantially more than half of its assets (defined as 65 percent or more of the fair market value of the organization's assets) to its charitable activities or to functionally related businesses.

(iii) The *endowment test* is met if it has an endowment based on 2/3rds of its minimum investment return;[24] in other words, if the foundation normally makes qualifying distributions directly for the active conduct of the activities for which it is organized and operated in an amount not less than two thirds of its minimum investment return, it meets the endowment test.

(iv) The *support test* is met if it derives substantially all (at least 85 percent) of its support from the general public and five or more exempt organizations, and not more than 25 percent of its support is received from any one such exempt organization, and not more than half is received from gross investment income (such as interest and dividends).[25]

A *common fund foundation* is a private foundation that pools its contributions into a common fund.[26] The organization's common fund must be a fund that would be a supporting organization but for the right of any substantial contributor or his spouse to designate annually the recipient organizations of the income attributable to the donor's contribution to the fund, and to direct by deed or will the payment to a charitable organization of the corpus in the common fund attributable to the donor's contribution.[27] Assuming this classification applies, contributions made to a common fund foundation are treated as if made to a public charity.

A common fund foundation must contain provisions in its governing instrument requiring it to:

(i) distribute all of the adjusted net income of the common fund to one or more charitable organizations not later than the 15th day of the third month after the close of the tax year in which the income is realized by the fund; and

(ii) distribute all of the corpus attributable to any substantial contributor's contribution to the fund to one or more charitable organizations not later than one year after the substantial contributor's death, or the death of his surviving spouse if she has the right to designate the recipients of the corpus.

A *conduit, nonoperating foundation* is a private foundation that distributes an amount equal in value to 100 percent of all contributions received in a tax year by the 15th day of the third month following the close of its tax year.[28]

The contributions must be "qualifying distributions" which are amounts paid to accomplish charitable purposes, amounts paid to acquire an asset used or held for use directly in carrying out one or more of such charitable purposes, or qualified set-asides for these purposes.[29] Amounts paid to a private foundation (that is not a private operating foundation) or to an organization controlled by the foundation are not qualifying distributions.

Now that the deceptively exhaustive Section 509(a)(1) rules have been covered; the supporting organization rules follow.

2. <u>It's Not a Private Foundation if it is Described in Section 509(a)(2).</u>

Section 501(c)(3) organizations that "get out of jail" under Section 509(a)(2) are also called "publicly supported organizations," but as mentioned earlier, include "exempt function income" in the one-third support test. The one-third support test for a Section 509(a)(2) organization differs in additional ways and is a bit more stringent than in a Section 170(b)(1)(A)(vi) organization.

Section 509(a)(2) classification becomes necessary where donations from the general public are not sufficient (i.e. no major fundraising campaigns are planned or doable), but the organization expects to generate revenues through its activities (such as an artistic organization's performance of plays, or an exempt healthcare organization's fees for services). Such an organization may obtain much of its funding through a few wealthy donors and might consider Section 509(a)(2) classification as Section 170(a)(1)(A)(vi) requirements are unlikely to be met.

Hence, a simple walkthrough for Section 509(a)(2) status (which should be reviewed only when the easier Section 170(a)(1)(A)(vi) tests cannot be met) works as follows.

(i) *The organization must normally receive more than one-third of its support in each taxable year from "permitted sources" listed below.*[30] This requires consideration of a fraction; the denominator is "total support" as defined in Section 509(d);[31] the numerator is taken from amounts as described below.

(a) Gifts, grants, contributions, or membership fees from "permitted sources," and such "permitted sources" include persons *other* than "disqualified persons," from governmental units, or from organizations described in Section 170(b)(1)(A)(other than from clauses (vii) and (viii) therein). The text of the statute itself is confusing; to restate it differently, permitted sources include support from governmental units and from most Section 170(b)(1)(A) sources and anybody that is not a disqualified person.

(b) Gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business, and such receipts must be from permitted sources, including persons *other* than "disqualified persons," from governmental units, or from organizations described in Section 170(b)(1)(A)(other than from clauses (vii) and (viii) therein).

(ii) *In calculating the one-third test, receipts from any single permitted source are excluded to the extent that such receipts exceed the greater of $5,000 or 1 percent of the organization's support in such taxable year.*

(iii) *A Section 509(a)(2) organization must also meet both the gross investment income and unrelated business income test set forth in Section 509(a)(2)(B). An organization will meet this test only if it normally receives not more than one-third of its total support in each taxable year from gross investment income,*[32] *and from the excess of unrelated business taxable income over any unrelated business income tax imposed.*[33]

3. <u>It's Not a Private Foundation if it is Described in Section 509(a)(3)</u>.

The other way to "get out of jail" (i.e. get out of private foundation status) is Section 509(a)(3), which covers "supporting organizations." The rules here are quite extensive, so this Article will delay the discussion until later this year.

B. By the Way, the IRS Eliminated the Advance Ruling Period (But Hasn't Updated Form 1023).

The one-third tests are computed based on "normal" sources of support, which must look to complex testing rules over a five year period.[34] Prior to new temporary regulations under Section 170, applications for Section 501(c)(3) status needed either to use at least eight months of activity to determine if it met the tests or to apply for an "advance ruling," whereby the organization needed to file Form 8754 (Support Schedule for Advance Ruling Period) five years later. Effective September 8, 2008, the IRS changed that process. Applicants now automatically qualify for public charity status if they can reasonably expect that they will meet the tests during the first five years.[35] Whether or not such reasonable expectation exists is based on a facts and circumstances test, depending on whether "its organizational structure, current or proposed programs or activities, and actual or intended method of operation are such as can reasonably be expected to attract the type of broadly based support from the general public, public charities, and governmental units that is necessary to meet such tests."[36]

Form 1023, however, has not been revised to take out the Advance Ruling language on Page 11 of Form 1023. The IRS has published an "Errata Sheet" which tells the tax practitioner to basically ignore the outdated provisions in Form 1023 and follow instead the instructions in the Errata Sheet itself.[37]

III. Private Foundation Disadvantages – Dance with Who Brung Ya.

Assuming, after all attempts at parsing the mess of rules described above, an organization is left with no choice but to be a private foundation, what are the consequences? First, donors on average will be less likely to contribute to a private foundation; second, private foundations are far more high-maintenance than public charities, subject to a host of excise taxes not applicable to public charities. Major donors are more hesitant to contribute to private foundations because donations of cash or capital gain property to private foundations are more limited. Donations of cash to a private foundation are capped at 30 percent of the donor's contribution base and donations of capital gain property are capped at 20 percent of such base. [38]

The distinctions arise throughout the rarely-seen Sections 4940 through 4948 and are "simply" summarized here.

(i) Private foundations (that aren't private operating foundations) are subject to a 2 percent tax on their "net investment income" under Section 4940 (Excise Tax Based on Investment Income).[39]

(ii) Private foundations are subject to potential penalty taxes under Section 4941(a)("Taxes on Self-Dealing"), a fairly lengthy section. This section imposes a tax on *each* instance of "self-dealing," which is any transaction between a "disqualified person" and the private foundation itself. The tax is potentially severe; it amounts to 10 percent of the amount of the "self-dealing" transaction (paid by the disqualified person, along with another 5 percent tax paid by a "foundation manager" who cannot show that the self-dealing transaction was not willful or had reasonable cause). There is another 200 percent tax on the disqualified person, and a 50 percent tax on the foundation manager, if they don't correct the self dealing transaction after a certain amount of time (generally, if the practitioner notices it, fix it soon; if the IRS actually notices it, fix now!).[40]

This requires a bit more parsing of defined terms. The definition of "disqualified person" isn't cross-referenced early enough in Section 4941, but once it is "helpfully" cross-referenced in Section 4941(d)(2), we learn that a disqualified person is defined in Section 4946 (Definitions and Special Rules). Section 4946 is actually an entire section dedicated towards defining what a "disqualified person" is, at least for purposes of the Section 4941 tax. A disqualified person is basically any substantial contributor[41] or foundation manager.[42] And lest this is too simple, the IRS provides that a disqualified person also includes:

(a) an owner of 20 percent or more of the interest (or control) of any substantial entity contributor;

(b) any individual related (other than siblings) to such substantial contributor or foundation manager; or

(c) a corporation, partnership, or trust in which the substantial contributor or foundation manager owns or controls at least 35 percent of a substantial contributor, a foundation manager, or a 20 percent owner or an individual as described above.[43]

How the average individual preparing Form 990s or establishing a nonprofit is supposed to worm through these rules to determine if there is a disqualified person in the mix is anyone's guess.

What, then, is self-dealing? The practitioner goes back to Section 4941(d), which defines "self-dealing" as director or indirect:

(a) sale or exchange or leasing of property between a private foundation and a disqualified person (unless the property is made available to the public on terms at least as favorable as the terms made to the disqualified person and such property is functionally related to the organization's purpose)[44];

(b) lending of money or extension of credit between a private foundation and a disqualified person (unless the loan is without interest or other charges);

(c) furnishing of goods, services, or facilities between a private foundation and a disqualified person (excepted are furnishings such goods or services where the general public receives similar terms for goods, services, or facilities);[45]

(d) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a qualified person (unless such compensation is reasonable and necessary);[46] or

(e) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation (excepting incidental benefits);[47] and

(f) any agreement by a private foundation to make any payment of money or other property to a government official (other than an agreement to employ the government official after termination of government service within 90 days).[48]

(iii). Private foundations are also subject to an excise tax under Section 4942 (Taxes on Failure to Distribute Income). This is yet another mind-bogglingly complex section; the dumbed-down (i.e. to-the-point) purpose is to make sure private foundations do not hoard net income. The tax is 30 percent of a private foundation's "undistributed income," which is then defined as the difference between its "distributable amount" and any "qualifying distributions."[49] The "distributable amount" is generally a 5 percent minimum investment return on a private foundation's assets. "Qualifying distributions" are basically distributions for actual charitable purpose.[50] Naturally, this is all a huge oversimplification of what the rules actually are (since there are all sorts of funky adjustments to what makes up the distributable amount and what is a qualifying distribution), but hopefully the practitioners won't have to actually make this calculation anytime soon.

(iv). Under Section 4943 (Taxes on Excess Business Holdings), private foundations are subject to yet another 10 percent excise tax on any excess business interest holdings relating to businesses owned by disqualified persons. Another scarily long section, Section 4943, is directed at prohibiting rich folks from setting up tax-exempt charities that hold their own corporation's stock and basically doing what-ever with that stock (and avoiding taxes on it at the same time). Generally (but of course with lots of exceptions), private foundations can only hold up to 20 percent of the voting stock in a corporation, reduced by the amount of any stock held by disqualified persons.[51] The difference between the high amount (i.e. 50 percent) and the permitted amount (i.e. 20 percent) is the "excess business holding." Like the Section 4941 self-dealing penalty taxes, if the IRS finds out about excess business holdings and the private foundation doesn't give or sell it back somehow, there is a potential 200 percent penalty on the private foundation on top of the 10 percent tax.[52]

(v). Section 4944 (Tax on Investments Which Jeopardize Charitable Purpose) is a catch-all 10 percent excise tax assess on the value of investments which jeopardize the carrying out of any of the private foundation's exempt purposes. Uncorrected, an additional 25 percent tax is assessed on the private foundation, and a 10 percent tax is imposed on a knowing foundation manager. This is a fairly broad-based, discretionary penalty since, after all, what jeopardizes a charitable purpose? Generally where the foundations managers have failed to exercise ordinary business care and prudence.[53]

(vi). Finally, Section 4945 (unhelpfully titled "Taxes on Taxable Expenditures") imposes a 20 percent tax on the private foundation and a 5 percent tax on a knowing foundation manager on amounts expended for the purpose of influencing legislation or for study/scholarships which do not meet nondiscriminatory requirements in terms of selection.[54] Also under Section 4945, private foundations are required to exercise "expenditure responsibility," meaning that upon receipt of a grant, the private foundation must make reasonable and adequate efforts to:

(a) see that the grant is spent solely for the purpose for which made,

(b) obtain full and complete reports from the grantee on how the funds are spent, and

(c) make full and detailed reports with respect to such expenditures to the IRS.[55]

IV. Conclusion (For Now).

There are plenty of helpful articles and web-based materials on the issue of public charities versus private foundations, but many are geared towards the layperson. Hopefully this Article presents it in a different manner that enables the tax practitioner not entirely familiar with the tax-exempt Code provisions to better follow the Code and thus more effectively advise clients when creating a charitable organization. Part I of this Article summarized the public charity versus private foundation distinction and explained the relationship between Section 501(c)(3) and Section 509, and all the Code branches growing haywire thereof.

Part II: Supporting Organizations will discuss the supporting organization rules in Section 509(a)(3) and the PPA '06 provisions that require heightened compliance and due diligence with respect to the three different "Types" of Section 509(a)(3) organizations.

ENDNOTES

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2 I.R.C. §501(c)(3)(italics added). The italicized language, as a good drafting principle, is typically incorporated in the purposes clause of the Certificate of Formation.

3 Id. §508(e).

4 And since these questions are usually for nonprofits with limited legal fee budgets, it's hard to track down every possible Code branch when evaluating classification decisions.

5 To appreciate how complex the public charity/private foundation distinction truly is, the Internal Revenue Service's ("IRS's") own internal continuing professional education ("CPE") on the topic, entitled "Public Charity or Private Foundation Status," can be downloaded at http://www.irs.gov/pub/irs-tege/eotopicb03.pdf. All 236 pages of it cover the topic in exhaustive detail – glumly quoting a district court's description of the private foundation rules as "fantastically intricate and detailed" in order to "thwart the fantastically intricate and detailed efforts of taxpayers to obtain private benefits from foundations while avoiding the imposition of taxes." Windsor Foundation v. U.S., 77-2 U.S.T.C. 9709 (E.D. Va. 1977)).

6 Employee benefits and corporate consolidated return specialists may take dispute with this allegation.

7 The author admits this is clear as mud. Section 509(a)(1) states that a private foundation does not include "an organization described in section 170(b)(1)(A) (*other than in clauses (vii) and (viii)*)."

8 I.R.C. §170(b) is entitled "Percentage Limitations." The deductibility limitations are shown in §170(b)(1)(B). Nobody ever gets that far because they get stuck on §170(b)(1)(A) and their eyes just glaze over (as such describing the types of entities is demanding enough).

9 I.R.C. §170(b)(1)(A)(i).

10 Id. §170(b)(1)(A)(ii).

11 Id. §170(b)(1)(A)(iii). The author has actually had to read this section in real life. In creating a medical research organization, note that medical research organization must be operated in connection with a hospital in order to automatically avoid private foundation classification under Section 170(b)(1)(A). Absent the hospital agreement, however, similar benefits may be offered as a private operating foundation under Section 170(b)(1)(F).

12 Id. §170(b)(1)(A)(iv).

13 Id. §170(b)(1)(A)(v). What is considered a governmental unit raises its own mess of questions that fortunately won't be covered in this Article (but which the author would be happy to discuss over a fine single-malt).

14 Id. §170(b)(1)(A)(vi).

15 Bruce Hopkins, a tax-exempt organization Grand Pooh-Bah, calls these "Donative Publicly Supported Charities." If you spend any significant time in this area, buy his book (even though the current edition is about 1300 pages long). No, the author of this Article does not get a kickback. See Bruce R. Hopkins, The Law of Tax-Exempt Organizations §12.3(b)(ii)(9th ed. 2007).

16 The Grand Pooh-Bah calls these "Service Provider Publicly Supported Charities." Hopkins §12.3(b)(iv).

17 1980 IRS EO CPE Text, Publicly Supported Organizations p. 4, available at http://www.irs.gov/pub/irs-tege/eotopicm80.pdf.

18 Treas. Reg. §1.170A-9(e)(10).

19 Remember the author mentioned this supra n. .

20 See supra n. .

21 See infra n. and accompanying text.

22 I.R.C. §4942(j)(3).

23 Treas. Reg. §53.4942(b)-1(c).

24 I.R.C.§4942(j)(3)(B)(ii); Treas. Reg. §53.4942(b)-2(b)(1).

25 I.R.C. §4942(j)(3)(B)(iii); Treas. Reg. §53.4942(b)-2(c)(1).

26 §170(b)(1)(A)(vii); §170(b)(1)(F)(iii); Treas. Reg. §1.170A-9(h).

27 This might make more sense later, because supporting organizations, discussed later, don't let contributors have that much say.

28 §170(b)(1)(A)(vii); §170(b)(1)(F)(ii); Treas. Reg. §1.170A-9(g). This one is easy; obviously if all a private foundation does is pay out all its monies each year to charitable purposes by its governing documents, the IRS has less to worry about.

29 §4942(g)(1), (2).

30 I.R.C. §509(a)(2)(A); Treas. Reg. §1.509-3(a)(2). Treasury regulations give the name "permitted sources" to the sources specified in the actual Code. Treas. Reg. §1.509(a)–3(d)(2)("Broadly, publicly supported organizations").

31 "Total support" includes gifts, grants, contributions, or membership fees, gross receipts from admissions, sales of merchan-

dise, performance of services, or furnishing of facilities in any activity which is not an unrelated trade or business net income from unrelated business activities, whether or not such activities are carried on regularly as a trade or business, gross investment income, tax revenues levied for the benefit of an organization and either paid to or expended on behalf of such organization, and the value of services or facilities (exclusive of services or facilities generally furnished to the public without charge) furnished by a governmental unit to an organization without charge. I.R.C. §509(d). Capital gains are specifically excluded.

32 Generally, gross investment income includes interest, dividends, royalties, and rents. I.R.C. §509(e). Where, however, rents are received in connection with the organization's exempt purposes (i.e. rent from low-income housing), such rents are applied towards support from a related activity. Treas. Reg. §1.509(a)–3(m)(1); I.R.M. 7.26.4.3.2 (04-01-1999).

33 I.R.C. §509(a)(2)(B); Treas. Reg. §1.509-3(a)(3); I.R.M. 7.26.4.3.1 (04-01-1999).

34 Normal sources exclude unusual grants from disinterested parties. Temp Reg. §1.509(a)-3T(c)(3) (outlining rules for determination whether grants are unusual).

35 Temp. Reg. §1.170A–9T(f)(4)(v).

36 Id.

37 See Errata Sheet for Form 1023 - To Be Used to Complete Parts IX and X, available at http://www.irs.gov/pub/irs-tege/errata_sheet_for_form_1023_final.pdf.

38 I.R.C. §170(b)(1)(B); 170(b)(1)(D).

39 I.R.C. §4940(c). Of course, "net investment income" has to be defined as "gross investment income" less "allowable expenses." Gross investment income is simply dividends, interest, royalties, and the like, and "allowable expenses" are investment-type expenses. Id. §4940(c)(1)-(4).

40 I.R.C. §4941(b); 4941(e).

41 Guess what? "Substantial contributor" is defined by yet another cross-reference to §507 (Termination of Private Foundation Status). This section defines a substantial contributor as any person who contributed more than $5,000 to the private foundation, if such amount is more than 2 percent of the total contributions received by the foundation before the close of the taxable year of the foundation. I.R.C.§507(d)(2).

42 A "foundation manager" is at least still defined in §4946(b), and includes any officer, director, or trustee of a foundation as well as any employee with authority or responsibility to act with respect to the transaction in question. I.R.C. §4946(b).

43 I.R.C. §4946.

44 Also excepted are no-charge leases between the disqualified person and the private foundation. I.R.C. §4942

45 Leases of office space between the private foundation and the disqualified person are permitted without charge, even where the private foundation pays for maintenance and expenses so long as the payment is not made directly or indirectly to the disqualified person. Treas. Reg. §1.4391(d)-2(d)(3).

46 Treas. Reg. §1.4391(d)-2(e).

47 Treas. Reg. §53.4941(d)-2(f).

48 I.R.C. §4942(d)(1)(a)-(f).

49 I.R.C. §4942(c).

50 Id. §4942(g).

51 I.R.C. §4943(c). If an unrelated third party has effective control of the corporation and the private foundation and disqualified persons do not together own more than 35 percent of the corporation, the permitted holdings is 35 percent. The author doesn't make these rules up.

52 I.R.C. §4943(a), (b).

53 Investments that Jeopardize Charitable Purposes, IRS 1988 EO CPE Text, *available at* http://www.irs.gov/pub/irs-tege/eotopick88.pdf.

54 I.R.C. §4945(a), (b).