

# Supporting Organizations: Options, Opportunities, and Challenges



Supporting organizations are flexible and entrepreneurial vehicles for family philanthropy. Families who know the specific causes they wish to support, and who are comfortable sharing control of their grantmaking with publicly appointed board members, may well find supporting organizations to be the most appropriate option for their philanthropic goals. • Families seeking to support the programs and goals of a specific community institution, such as a hospital, university, or museum, may choose to establish supporting organizations with these charities. Families who have more general interests in a

community or issue area may establish a supporting organization in partnership with another appropriate public charity, such as a community foundation, Jewish Federation, or other public grantmaking institution.

Supporting organizations (“SOs”) were created as part of the 1969 Tax Reform Act to allow a single donor, family, or corporation to support a specified institution or cause, or set of specified institutions or causes. SOs operate in a manner similar to private foundations, but have additional restrictions that in turn make them eligible for other key advantages available only to public charities. This makes SOs an attractive option for those families willing to abide by these additional restrictions.

The most important necessary condition for SO status is that the governing board of the SO be controlled by one or more public charities (PCs). While this does not mean that family members can not serve on the board of the SO—up to 49% of an SO’s board can be family members or other disqualified persons—it does mean that the family must give up some measure of control over the SO’s activities. This and other requirements are described more fully later in this paper.

Families are encouraged to seek out experienced counsel prior to establishing an SO, and to carefully consider the options available to them. (See

the chart on page two for a full comparison of three key options for family philanthropy.)

This *Passages* issue paper looks at the options, opportunities, and challenges of SOs from the family’s viewpoint. The paper addresses the considerations of why and how families establish these vehicles in a non-technical context, and provides guidance around how they are typically structured and managed.

One of the biggest obstacles to the use of supporting organizations has been the lack of an objective and clear description of their opportunities and challenges. We hope that this issue paper provides just that.

## INTRODUCTION TO OPPORTUNITIES AND CHALLENGES

Assuming that the requirements regulating these vehicles can be met, SOs allow families to combine key benefits of a private foundation—a central role in governance and grantmaking, training opportunities for the next generation, and a family philanthropic legacy—with those of a donor-advised



**FIGURE 1: SUPPORTING ORGANIZATIONS, DONOR-ADVISED FUNDS, AND PRIVATE FOUNDATIONS**

MANAGEMENT AND OTHER ISSUES	SUPPORTING ORGANIZATIONS	DONOR-ADVISED FUNDS	PRIVATE FOUNDATIONS
<b>Control of grants and assets</b>	Donor family may recommend grants and investments, but the parent organization has significant input in all final decisions	Donor may recommend grants and investments, but the parent organization makes all final decisions	Donor family has complete control of all grantmaking and investment decisions, subject to self-dealing rules
<b>Required payout</b>	None, but must demonstrate ongoing support for named public charities or causes	None	Must expend 5% of net asset value annually, regardless of how much the assets earn
<b>Privacy</b>	Must file detailed and public tax returns on grants, investment fees, trustee fees, staff salaries, etc.	Names of individual donors can be kept confidential if desired	Must file detailed and public tax returns on grants, investment fees, trustee fees, staff salaries, etc.
<b>Governance and Succession</b>	Opportunities for board selection, training, and bringing in the next generation. Majority of board must at all times be independent, non-family trustees typically appointed by named public charities.	Some parent organizations encourage the continuance of donor-advisors from one generation to the next; many do not. The IRS is still considering succession issues.	Opportunities for board selection, training, and bringing in the next generation are greater. No restrictions regarding who serves on board.
<b>Perpetuity</b>	Supporting organization can exist in perpetuity	Most donor-advised funds revert to the parent organization after the original donors or the succeeding generation passes away	Foundations can exist in perpetuity
<b>Start-up Costs</b>	Legal fees and other start-up costs can be substantial	Minimal and often covered by parent organization	Legal fees and other start-up costs can be substantial
<b>Ongoing Administrative and Management Costs</b>	Varies with choice of SO board, and level of services required (typical range: 1/2 % to 2 % of assets per year, depending on size of SO)	Varies with parent organization and level of services; typically less than SOs or PFs	Varies with choice of board, and level of services required
<b>Tax deduction limits for gifts of cash*</b>	50% of adjusted gross income	50% of adjusted gross income	30% of adjusted gross income
<b>Tax deduction limits for gifts of stock or real property*</b>	30% of adjusted gross income	30% of adjusted gross income	20% of adjusted gross income
<b>Excise taxes</b>	None	None	Excise tax of 1% to 2% of net investment income annually
<b>Valuation of gifts</b>	Fair market value	Fair market value	Fair market value for publicly traded stock; cost basis for all other gifts, including gifts of closely held stock or real property

\*Excess in any year's donations can be carried forward up to five years.

fund. The latter include tax advantages, grantmaking advice, and administrative/management support.

Other key advantages of SOs include:

- Supporting organizations allow families to work closely with public charities that they feel can accomplish the family’s key charitable objectives.
- Public directors and staff of the supported public charities may be available to help train the next generation about philanthropy, and to help preserve the donor’s philanthropic vision.
- Supporting organizations provide opportunities for long-term recognition of the family in their name and mission.

Establishing a supporting organization presents its own set of challenges. SOs can be difficult and relatively expensive to establish and operate on an ongoing basis, and place specific restrictions on the role of donors and family members. Although SOs have existed as a legal entity for more than 30 years, few advisors are familiar with the rules governing them. Public charities are often unwilling to be affiliated with SOs because of the need to devote staff time to comply with these regulations. Finally, and perhaps most importantly, the IRS has expressed concern about the use of SOs to bypass rules governing private foundations. Some observers speculate that the nature of SOs may change in future years to one that is less “donor-friendly.”

### SUPPORTING ORGANIZATION STRUCTURES

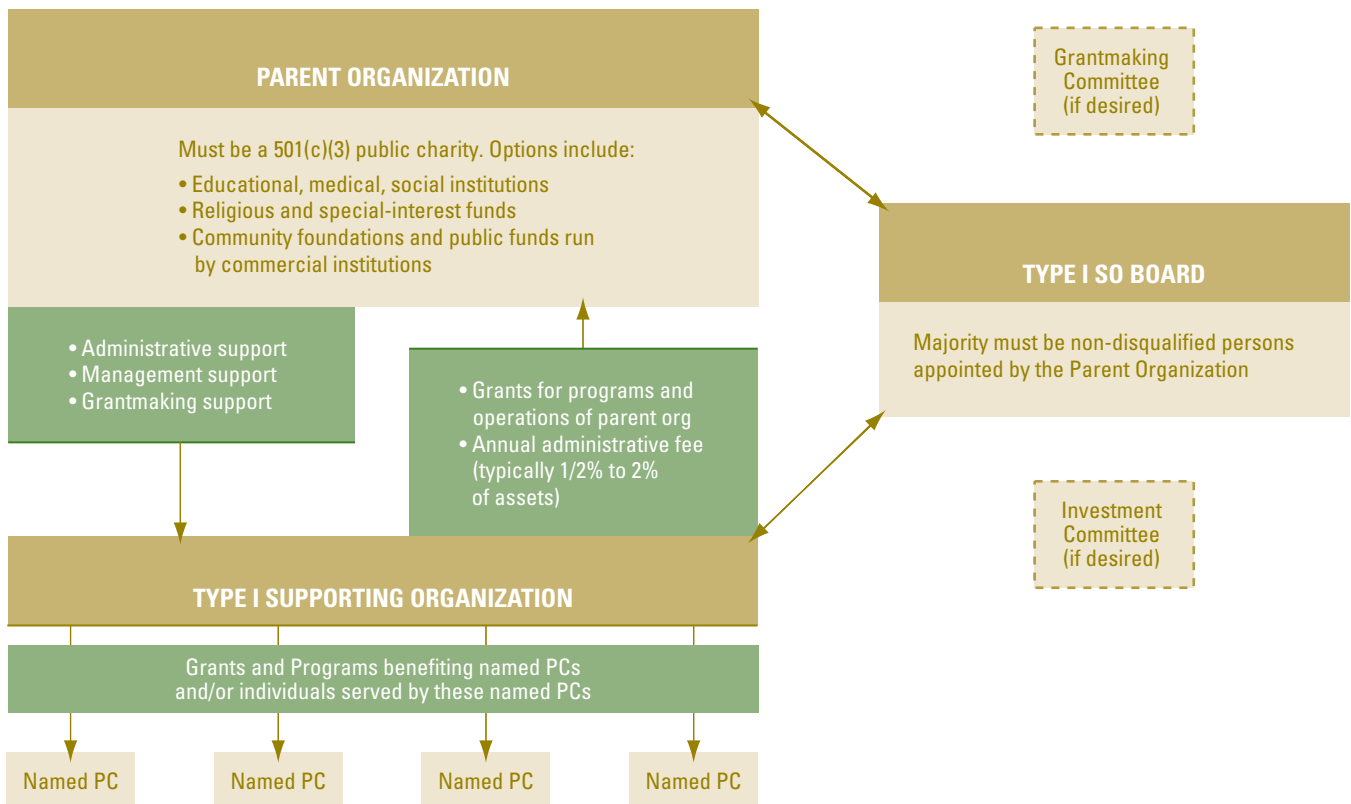
Families may choose from one of two basic supporting organization structures. The first—and more common—is to establish what is often referred to as a “parent-subsidary” relationship with a specified public charity. Type I supporting organizations, as these are called, may be affiliated with a university, hospital, or other leading community institution with focused programs and interests. They may also be established with an organization that supports a broader range of causes in a specific community or region—such as a Jewish Federation or a community foundation.

The primary requirements of a Type I SO are that the parent organization appoint a majority of the SO’s board, and that the majority of the board be non-disqualified persons with respect to the SO (see Figure 6 on page 10 for information on non-disqualified person). In addition, all grants and activities of a Type I SO must fulfill the charitable purposes of its named PCs.

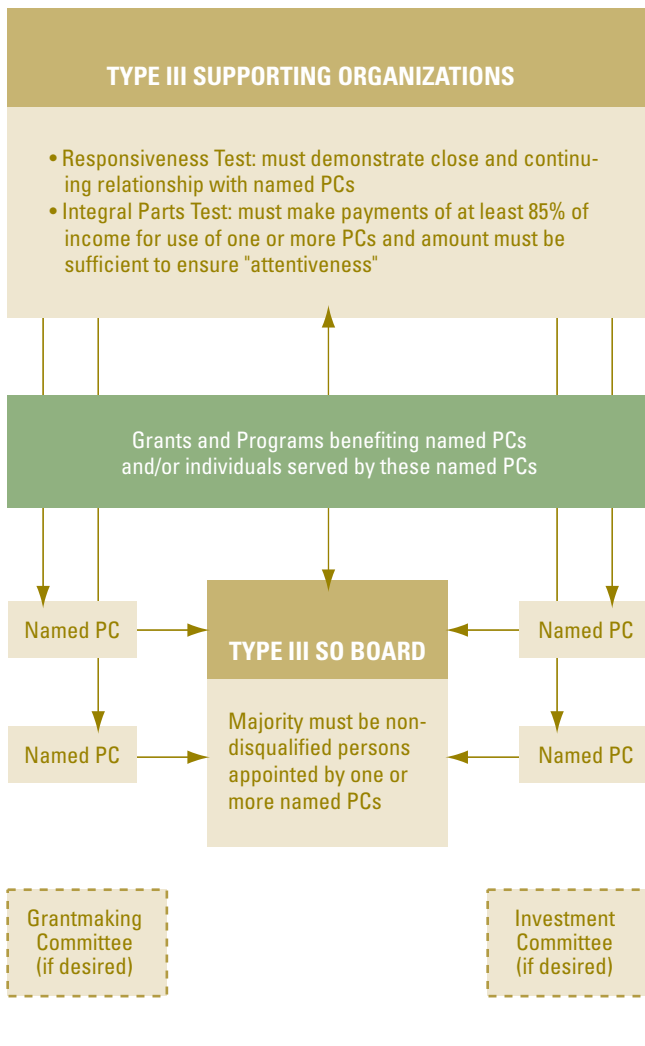
The typical structure for a Type I SO is illustrated in Figure 2.

*Art and Sandy McAlister created the Good Health Supporting Organization (fictional name) to support organizations providing elder care in their community. The McAlisters decided to establish a Type I supporting organization with a parent-subsidary relationship at a local hospital that had provided*

**FIGURE 2: TYPICAL TYPE I SUPPORTING ORGANIZATION STRUCTURE**



**FIGURE 3: TYPE III SUPPORTING ORGANIZATION**



care for each of their parents. The bylaws of Good Health specify that the Board be made up of three directors chosen by the donor’s family (currently the McAlisters and their daughter), as well as four representatives appointed by the hospital, thus meeting the control and relationship tests of Type I SOs.

In addition to making grants to the hospital on an ongoing basis, Good Health makes grants to a number of other public charities named in its founding document. Good Health also occasionally funds other elder care programs identified by its community grantmaking committee, which is made up of hospital staff and community members.

Families may also choose to establish a Type III supporting organization. Type III SOs need not be controlled by any one public charity, as is the case with Type I SOs, but must demonstrate a close and continuing relationship with their named public charities in other ways. Typically the family works with its named PCs to establish the board,

which again must be made up by a majority of non-disqualified persons.

Some observers note that Type III SOs provide the family with a greater level of control than their Type I cousins, due to the fact that no single public charity is required to name a majority of the board members. However, Type III SOs must meet two additional tests, known as the responsiveness test and the integral parts test. The latter test typically requires that the SO make payments of substantially all (at least 85 percent) of its income to or for the use of one or more of its named PCs, thus restricting the flexibility of a Type III SO’s grantmaking. Additional information on these tests can be found in Figure 6 on page 10, or in the “Additional Selected Resources” listed at the end of this paper.

John and Phyllis Johnson (fictional name) established the Johnson Supporting Organization (also known as the Johnson Foundation), a Type III supporting organization, to support the Johnson Center for Early Childhood Development at their local state university. The Johnson Foundation also named a donor-advised fund with their local community foundation as one of their supported public charities.

The Johnson Foundation satisfies the responsiveness test by virtue of the fact that representatives from both the university and the community foundation serve on its board. The Board also includes Mr. and Mrs. Johnson, their oldest son, and two outside experts in early childhood development. Four of the seven board members are thus non-disqualified persons, fulfilling the control requirement established for all SOs. The foundation complies with the integral parts test requirement by distributing more than 85% of its income to the research center on an annual basis. The foundation also makes regular contributions to the donor-advised fund, which is able to recommend grants to other public charities, or to hold onto these funds for future causes.

**KEY REASONS FAMILIES USE SUPPORTING ORGANIZATIONS**

Families that have discovered or been advised to form a supporting organization often find a model that suits a wide variety of their goals and needs. Key reasons that families use supporting organizations include:

**Supporting organizations allow the family to retain some control of the grantmaking while providing opportunities for access to administrative, grants management, and investment management support.** Families that choose to establish a parent-subsidiary relationship with an individual public charity often do so because of the support available from the parent organization. The exact nature of this support can take different forms, but may include activities such as tax reporting, grantmaking administration, accounting, and/or investment management. At the same time, families retain significant control of the philanthropy by virtue of their membership on its board, and their ability to approve non-family trustees. This

provides them with ongoing input into the selection of grantees, the grants review processes, and, if desired, the investment and overall management of the organization.

Stanley and Dorothy Frank established *The Stanley and Dorothy Frank Family Foundation* as a supporting organization of the Community Foundation for Greater Greensboro after considering other options for leaving a legacy to the community that meant so much to them. The Franks liked the stability and support the parent-subsidiary relationship offered. “The community foundation will always be there to administer the residuary of my estate,” says Mr. Frank. “I felt safer—administratively—knowing that our family estate would be properly protected and that our requests would be carried out in perpetuity.” The Frank Family Foundation makes grants to projects that are identified for support by its board, which consists of representatives from both the Frank family and the community foundation. In addition to administrative support, the community foundation also provides expertise in grant-making areas when requested.

**Supporting organizations are free of key restrictions placed on private foundations.** Because SOs are subject to the oversight and control of one or more public charities, the IRS has freed them from several important private foundation restrictions:

- They are not subject to the annual one-to-two percent excise tax on net investment income, or to excise taxes on jeopardy investments or taxable expenditures
- They are not subject to the self-dealing rules of private foundations, and thus are not restricted from selling assets at fair market value to family members or family business entities
- They do not have the five percent annual payout requirement of private foundations, and thus may in some cases choose to accumulate assets for a period of time to increase future grant sizes or to build back after investment losses
- They are not subject to the excess business holdings rules of private foundations, which require that a private foundation dispose of its holdings in a closely held business within five years of receipt
- They may make grants to individuals (such as scholarships) without the need for special permission from the IRS

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**Supporting organizations allow the donor(s) to receive tax benefits equal to that of gifts to other public charities, and better than that for making gifts to a private foundation.** SOs have distinct advantages over private foundations in terms of the tax benefits they receive (see chart on page 2 for details). SOs may also accept a variety of unusual assets—including gifts of property, real estate, and closely held stock—while getting the best tax benefits for these gifts.

*(continued on page 8)*

## Figure 4:

### AN INTRODUCTION TO THE THREE TYPES OF SUPPORTING ORGANIZATIONS

There are a wide variety of rules governing supporting organizations, and it is essential that you have experienced and capable legal assistance before establishing an SO. A complete list of resources addressing the more technical aspects of SOs is included on page 12.

Congress created three basic types of supporting organizations as part of the 1969 Tax Reform Act, each with different rules regarding establishment and reporting requirements. In each case, the supporting organization is required to establish and confirm on an ongoing basis a direct relationship with one or more public charities (PCs). Summary descrip-

tions for each of the three types of supporting organizations are as follows:

**Type I supporting organizations** are “operated, supervised, or controlled by” their supported public charity. This is the case if the PC appoints the majority of the SO’s board. Some commentators compare this to a “parent-subsidiary” relationship, with the “parent” being the primary supported public charity.

**Type II supporting organizations** are those where the SO is “supervised or controlled in connection with” PCs. Because this requires that the governing board of a Type II SO be identical to

that of the specified public charity, Type II SOs are not appropriate for family goals, and are not addressed in this issue paper.

**Type III supporting organizations** are “operated in connection with” one or more PCs. Type III SOs can provide the most flexibility for the donor and family, but must satisfy additional tests known as the “Responsiveness Test” and the “Integral Parts Test.” These tests involve complex rules regarding how the Type III SO is connected to its PCs. See page 10 for more information about these additional tests.



## THE SHERWICK FUND: ESTABLISHED BY A FAMILY OF VISION

**J**ohn Sherwin Jr., and his daughter Heather, family trustees of the Cleveland-based Sherwick Fund, know a little bit about effectively governing a supporting organization. The fund that was established in 1973 by John Sherwin Sr., Jack's father, is the oldest such organization in the United States.

John Sherwin Sr. established a private foundation in 1953 to give back to the community in which he had made his career and raised a family with his wife, the former Frances Wick. Over time, he and his wife determined that the private foundation structure was not meeting all of their philanthropic needs. "My father was actively involved with The Cleveland Foundation," says Jack Sherwin, "and he realized that having access to its staff would be invaluable in helping his foundation respond to the growing number of requests coming in. He asked himself, 'How can our private foundation access the staff and expertise of this public foundation?' He and his attorney, Norm Sugarman, petitioned the IRS to allow them to do just that."

Under the terms of Section 509(a)(3) of the Tax Reform Act of 1969, The Sherwick Fund became the first supporting organization in the country. The Fund was originally established as a separate grantmaking entity with approximately \$1.3 million in assets. In 1993 the assets of the fund were joined with The Cleveland Foundation, and by March 2001, through subsequent contributions by the family and market appreciation, the fund had grown to nearly \$28 million.

### Board Membership and Grantmaking Decisions

The Sherwick Fund's Board has five trustees—two chosen by the family, and the remaining three appointed by The Cleveland Foundation (the latter may not be "disqualified persons" with respect to the donor family). This satisfies the condition that the publicly-supported organization retain effective control of the Fund. Meetings are held in Cleveland, and take place at least twice a year.

The Fund's Code of Regulations also provide for "Successor Donor Members" (see box on next page). This allows the family to continue being involved in the governance of the Fund for multiple generations, and if needed

#### PURPOSE OF THE FUND

"This corporation is organized and shall be operated exclusively for charitable, educational, scientific, and religious purposes, by making distributions which exclusively benefit or carry out the charitable, educational, scientific and religious purposes of The Cleveland Foundation so long as the Foundation and all distributee organizations are organized, and at all times operated, as organizations described in §509(a)(1) or (2) of the Internal Revenue Code of 1954."

—from the AMENDED ARTICLES OF INCORPORATION OF THE SHERWICK FUND

to appoint non-family individuals as temporary "Donor Members" in cases where no family member is ready to become a trustee. In 1989, when John Sherwin Sr. was ready to step down but no other family member was interested in becoming a trustee of the fund, the family invited former Cleveland Foundation Director, and long-time family friend, Homer Wadsworth, to represent the Sherwin family as a donor member. In the early 1990s, Heather began to express interest in the Fund, and in 1994 she succeeded Mr. Wadsworth.

Although the law requires that the public member (in this case The Cleveland Foundation)

have majority control of the board, both Jack and Heather say that the relationship between public and donor members is purely collaborative. "It is not in their best interests to disagree with our suggestions," says Heather, "and it is in our best interests to have someone with skills and connections that are different from ours. There was a gentleman on our board who was an African-American attorney, involved in many areas of the community that we were not connected to. He brought a broader perspective than we alone could bring."

Jack notes that The Cleveland Foundation is careful to appoint public members who connect with the family trustees in terms of both personality and interests. "We've had a couple of cases where members of the board have said, 'Are you sure you want to do that?' But there's never been a case where there was anything that we couldn't do." Jack adds that although his father set up the fund so that only two family members could serve as trustees at any given time, a supporting organization does not have to exclude family members who are not official trustees. There is nothing that prevents the Board from amending the governing documents to add additional trustees (as long as the public member retains more than 50% of the board membership), or from having separate family meetings to discuss grant suggestions and to have the appointed donor trustees serve as delegates for the entire family.

### Staff Support: Grantmaking and Investment Management

Heather says that Cleveland Foundation staff recommend many of the Fund's potential grantees, and provide ongoing guidance on all

requests. “If you have questions about the stability of an organization, or the validity of a project, you’re going to get a real answer from a program officer. If you’re running the foundation yourself, often your only source of information is the development officer for the nonprofit.” Cleveland Foundation staff also arrange presentations and discussions with community experts in many of the key areas in which Fund trustees have expressed an ongoing interest—notably youth development, health, and education. While the majority of all grants disbursed are made in response to a request from a grantee, trustee-initiated grant dollars have at times been higher in areas such as support for the arts, health, and education. During the 2000 grant cycle, the Fund made 66 grants totaling over \$1.27 million dollars. Since 1973, the fund has made nearly 1100 grants totaling more than \$16.4 million dollars.

In addition to the administrative and grantmaking support it receives, The Sherwick Fund also benefits from its relationship with The Cleveland Foundation with regard to investments. “We pool many of our resources with the investment managers of the foundation,” says Heather. “We have nationally-known investment advisors managing our funds, and our performance has been equal to that of the larger foundation.” Jack adds, “You have a lot more say in financial management of the funds than you have with other options at the community foundation. We’re a trust within Key Bank, but we can pull it out in a heartbeat if necessary.” The Fund pays an annual management fee of one-half of one percent of assets to The Cleveland Foundation for these and other services.

### Spending Policy

As a Type 1 supporting organization The Sherwick Fund does not have an annual grants payout requirement. However, in keeping with the spirit and intent of the founder, the trustees of the fund decided on a spending policy of 4.75 percent, based upon an average of the market value of its assets over the 12-quarter period through June of the prior year. Fifteen percent of this payout is for annual and discretionary

grants with which the Sherwin family has had long association; thirty-five percent is in response to proposals from organizations and projects in the Greater Cleveland area; and half goes to a cause or issue that the trustees have decided needs special attention in any given year.

An interesting approach the trustees have taken is to give principal grants. These grants are not counted against the annual spending policy, and may be made only for major projects (usually capital) of particular interest to the family and the trustees. In 1999, the trustees authorized up to \$4.2 million to be spent from principal over the following five-

#### SUCCESSOR DONOR MEMBERS

“Each Donor Member may from time to time designate a person to serve as that Donor’s successor, for a limited period of time or indefinitely, either during the Donor’s life or after the Donor’s death... . If for any reason any person ceases to be a Donor Member, the person so designated shall become a Donor Member to serve as herein provided, and in the event any Donor Member fails to so designate a successor hereunder the vacancy shall be filled by a majority vote of the remaining Donor Members...”

—from the AMENDED CODE OF REGULATIONS OF THE SHERWICK FUND

year period. “I have no interest in The Sherwick Fund becoming the largest supporting organization in the country,” says Jack, in explanation of the rationale behind this decision. “We want to use these funds to benefit Cleveland.” Heather adds that this policy also provides the Board with some flexibility, and reflects the importance that the Fund places on family interests that are consistent with the goals of The Cleveland Foundation. “We have a requirement for these grants that at least one family member is on the board or heavily involved with the grantee.”

### Ongoing Family Involvement

Although Jack and Heather are the only family members to have served on the board aside from the donor, they note that other family members are involved in a variety of ways. “My brother Tyler has taken a personal interest in the Fund,” says Heather. “Dad shares financials and other pre-docket information with him, as well as ongoing grant decisions. My mom lives in Cleveland and a lot of the programs and organizations we support are things that she is involved in. It’s all about who takes an interest.” She adds that the board will consider contributing to organizations outside of the Cleveland area—the founding documents allow for up to 20% of grants to be made outside of Cleveland and the five surrounding counties—provided that one or more family members play an active role in the organization.

Still, at the end of the day, Heather says that, “you have to live in the city of Cleveland to officially serve on the Board. You don’t have a lot to add to the discussions if you are just flying in once or twice a year. If my brother returns to the Cleveland area and expresses interest in serving on the board, my dad and I have talked about rotating membership on the board rather than increasing its size.”

### Future of the Fund

Jack and Heather are both confident that the family will remain involved in the Fund at some level for many years to come—but only if they are truly interested. “Don’t bother getting into this if you aren’t willing to participate in running the organization,” says Jack. “If you are interested and committed to being involved and doing something, this is a terrific opportunity for any family.”

Both have made plans to give personally to the fund: it is in Heather’s will, and Jack has a unitrust fund with The Sherwick Fund as one of the beneficiaries. “This fund has been wonderful to us,” concludes Jack. “Being active in the fund keeps us involved in the community and allows us to act on the values of community involvement that have been passed along by my parents. It’s been a terrific vehicle.”

Byron and Linda Johanson (fictional name) *owned appreciated closely held stock and were considering using three million dollars worth to establish a private foundation to support Lutheran causes and other family interests. Because the stock was closely held, the deduction for their gift would have been limited to cost. The Johansons instead chose to establish a supporting organization with the local Lutheran social services center, allowing them to deduct the current value of the stock and still be directly involved in making grants to charity.*

**Public directors and staff of the parent organization can help train the next generation about philanthropy, and can help pass along and ensure that the donor's philanthropic vision is preserved.** Public directors and staff of parent organizations often have in-depth knowledge of a local community or issue area, and can help train current family board members about both grantmaking issues and governance responsibilities. Families that establish supporting organizations may also

choose to form advisory boards or committees of younger family members. These advisory committees may be given the opportunity to make recommendations on a small portion of the SO's funds, much as an advisory committee to a private foundation might do.

*The Mielke Family Foundation was established in 1963 by Dr. Edward F. Mielke and his wife Beulah. Community-minded throughout their lives, Dr. and Mrs. Mielke and his two sisters, Ruth and Sarah, established the foundation to enhance the quality of life for residents of the towns of Appleton and Shawano, Wisconsin. In 1996 the foundation reorganized to become the first supporting organization of the Community Foundation for the Fox Valley Region. Members of the second and third generation of the Mielke family are active participants in the work of the SO, which is overseen by a board of directors including residents of the Appleton and Shawano communities. Family members have established Generation II and*

## Figure 5:

### STEPS FOR ESTABLISHING A SUPPORTING ORGANIZATION

**1. Identify qualified advisor experienced in non-profit legal issues to assist with establishing the organization's structure, organizing documents, and applications.**

Because of the technical requirements of supporting organizations, having an advisor who has direct experience with SOs is essential to the future success of the organization. This individual should also be available to help the family with step two.

**2. Review your goals for your family, your community, and your philanthropy, and determine appropriate giving vehicle.**

Use the chart on page two, and hold discussions with family members, community leaders, and the advisor you have identified in step one. If you decide on the SO option, proceed with steps three through eight.

**3. Review types of supporting organizations and determine which type to establish:**

- Type I: Easiest requirements to meet but requires the SO to agree to a parent-subsidiary relationship

- Type II: Not appropriate for family goals
- Type III: Provides the most flexibility for the donor and family, but more difficult to establish and maintain

**4. If establishing a Type I SO, choose a public charity to act as parent entity for your SO, and work with them to define how they will serve in this role.** Discuss issues such as minimum size of fund, successor advisors, annual fees, staff support, board makeup, and other areas.

**5. Establish articles of incorporation and complete application for exemption electing supporting organization status.** This will require the assistance of the individual identified in step one, as well as discussions with the public charities you are planning on supporting.

**6. Work with parent organization or other named PCs to determine founding board of directors.** You will need to ensure that more than half of the trustees for the supporting organ-

ization are not disqualified persons, as defined in the IRS guidelines. Allowing the public charity to name these individuals will help ensure that you meet these IRS requirements.

**7. Satisfy IRS requirements for relationship with benefited public charities.**

**8. Create reporting and communications agreements with PCs.** Establishing clear communications early on will help to keep your relationship clear and legal, and will minimize misunderstandings in the future. Remember that not all organizations are comfortable being affiliated with supporting organizations—particularly of the Type III variety—and make sure that all public charities that you plan to name in your articles of incorporation are aware of their relationship to your SO.



*Generation III funds to perpetuate the Mielke family's philosophy of giving back to their community.*

The Haffenreffer Family Fund was established in 1943 by Rudolph Haffenreffer as a private foundation and became a supporting organization of The Rhode Island Foundation in 1987. Rudolph's children, grandchildren, and great-grandchildren continue to be actively involved, meeting together as a family annually to recommend grants. Rhode Island Foundation staff manage and administer the Fund's grant-making and investments.

**Supporting organizations provide opportunities for long-term recognition of the family in their name and mission.**

Many supporting organizations take on the name of the donor family, and choose PCs that directly address their key concerns. Some SOs have developed full-fledged websites to share their philanthropy—including the philosophy and purpose behind that philanthropy—with the general public. A prime example is the Kirsch Foundation, established in 1999 by Michele and Steve Kirsch (the founder of Infoseek) as an SO of the Community Foundation Silicon Valley. In addition to providing updates on their giving, the foundation's website (<http://www.kirschfdtn.org/>) also features Mr. Kirsch's personal reflections on philanthropy, and provides descriptions and links to its affiliated organizations. The Kirsch Foundation also uses its supporting organization status to engage in advocacy efforts. "You only make a difference by getting legislators to pass laws to fix the system," says Mr. Kirsch.

**Supporting organizations allow families to work closely with—and have influence on—one or more existing public charities that they feel can accomplish their key charitable objectives.** Many observers note that supporting organizations allow donors to more effectively enter into and enjoy the benefits that come from a private partnership with a public charity. This may make the SO option particularly attractive for entrepreneurial donors seeking to engage in so-called "venture philanthropy," and looking for a hands-on relationship with the charities they choose to work with.

Bill and Claudia Coleman established the University of Colorado Coleman Institute for Cognitive Disabilities to fund advanced research and the development of technologies that respond to these disabilities. The founders have observed the connection that this institute has to both their personal and professional lives. They have a home in Aspen and a niece with special needs, and Mr. Coleman says that the company he founded, BEA Systems, had focused much of its work on "the development of personalization technology for the Internet and possible techniques to help those with cognitive disabilities." This focused mission and interest—and the desire to play a continuing role in the Institute—led the Colemans to establish the \$250 million supporting organization at the university.

*The Colemans visit the institute regularly to meet with staff and provide input on its future directions.*

The Turner Family Foundation was established as a legacy to its donor, J.A. (Jim) Turner Jr., the founder of National Welders Supply, who led the company until his death in 1998. Created as a supporting organization of Foundation For The Carolinas, the Turner Family Foundation has provided support for a number of projects close to Mr. Turner's heart, including the Jim Turner Center for Welding Technology. According to Judy Carpenter, Mr. Turner's daughter and the Chair of the Board of National Welders, "The goal is to offer welders a way in which to achieve professional status in their field."

One federal court has stated that the Treasury Regulations regarding supporting organizations are "fantastically intricate and detailed."

**Supporting organizations provide a helpful option for transferring the assets of a private foundation to a public charity.** Some family foundations find that they are supporting a select number of grantees, or that there is limited interest among family members in running the foundation on a day-to-day basis. In such cases, the family may want to consider converting the foundation to a supporting organization of a community foundation or other public charity to receive the benefits of being a public charity. This process takes a minimum of five years, however, and any family considering this option should be sure to have appropriate counsel.

**KEY CHALLENGES OF SUPPORTING ORGANIZATIONS**

As noted previously, supporting organizations are not without their challenges:

**Rules are unfamiliar to many advisors and can be complicated and frustrating for the family and the charities that you wish to support.** One federal court has stated that the Treasury Regulations regarding supporting organizations are "fantastically intricate and detailed." Because of this, and because of the fact that not all charities will want to become closely involved with an independent entity over which they have limited control, some charities may have policies against affiliating with SOs. Having experienced counsel—for both the family as well as for the supported charities—to help interpret

# Figure 6:

## TESTS FOR ALL SUPPORTING ORGANIZATIONS

There are four tests that all supporting organizations must meet. See “Additional Resources” on page 12 for details on these and other technical requirements.

**Organizational Test.** Supporting organizations must be organized and operated exclusively to perform the functions and/or to carry out the purposes of one or more specified public charities. An SO’s governing instruments should specifically state that the purpose is limited to carrying out activities permitted by Internal Revenue Code section 509(a)(3) and should specify the PCs that the SO will support.

**Control Test.** Supporting organizations may not be directly or indirectly controlled by disqualified persons. For

purposes of this test, the disqualified person is defined under Section 4946 of the IRC, and a disqualified person remains so even if they are appointed by the PCs. Disqualified persons include relatives and employees of the donor, as well as some other specified individuals.

**Operational Test.** Supporting organization activities must support, benefit, or carry out the purposes of one or more PCs, and all grants distributed by the SO must fulfill the charitable purposes of its named PCs. Because of this, many Type I SOs are established as community foundations or public charities with broad charitable purposes: in these cases, most any grant by the SO can be said to fulfill the charitable pur-

poses of the supported public charity.

**Relationship Test.** This test requires that the SO be “operated, supervised, or controlled by” the PCs. This means that at least 51% of the SO’s governing body must be named and controlled by the PCs, and may not be disqualified persons. This can be accomplished by including in the bylaws a statement that a majority of the SO’s board must be appointed by the PCs, while a minority will be appointed by the donors. To distinguish these types of trustees, many supporting organizations use the terms, “Public Directors” and “Donor Directors”.

## ADDITIONAL TESTS FOR TYPE III SUPPORTING ORGANIZATIONS

Type III SOs allow the family to appoint the full board (subject to the control test described above), and thus provide donors and their families with greater control of the SO. In exchange for this increased control, Type III SOs must meet additional tests known as the “Responsiveness Test” and the “Integral Parts Test,” each designed to confirm that the SO is “operated in connection with” its named PCs on an ongoing basis.

**Responsiveness Test.** Type III supporting organizations must demonstrate that they are “responsive” to the needs or demands of their PCs. One of two sets of requirements can satisfy this test:

**Responsiveness Test #1.** Under the first set of requirements, the governing bodies of the PCs must demonstrate a close and continuing relationship with the SO by showing that they have significant input on: 1) the investment policies of the SO, 2) the timing of SO distributions, and 3) the selection of SO grants.

**Responsiveness Test #2.** The SO may also choose to satisfy a second set of sub-tests, in which case each of

the following requirements must be met: 1) the SO must be a charitable trust under state law; 2) each PC must be named in the governing instrument of the SO; and 3) the PCs must have the power to enforce the trust and compel an accounting under state law.

The first set of requirements provides more oversight to the supported charities, while the second is somewhat more subjective and flexible for the family. Using Test #2 may not be acceptable to the charities that the family seeks to support.

**Integral Parts Test.** Type III SOs must also satisfy an “integral parts tests” to ensure that the SO is closely involved in the operations of its PCs, and to ensure that each PC is dependent upon the SO for the support the SO provides. In order to meet this test, the SO must meet one of the two following conditions:

**Integral Parts Test #1.** An SO’s activities must perform the functions, or carry out the purposes of, one or more named PCs. It must also be true that “but for” the involvement of the SO, these activities would normally be engaged in by the PC (or

PCs) itself. An example of this might be a college that was considering establishing a branch campus or new research center, but lacked the resources to do so on its own. A family could establish a Type III SO to actively assist in the development and ongoing operations of the new center, thus meeting the “but for” requirement of the integral parts test.

**Integral Parts Test #2.** The SO must make payments of at least 85 percent of its income to/for the use of one or more of the PCs. Additionally, the amount of support received by the PCs must be sufficient to ensure their attentiveness to the operations of the SO. (See “What are the Distribution Requirements for a Type III Supporting Organization” listed in Resources on page 12 for more information).

Both the responsiveness and integral parts tests can be somewhat subjective. Because of this, it is important that you and your advisor work closely with the public charities you support to ensure that there is a clear understanding of the relationship between these PCs and your SO.

and explain the rules is a must for any family thinking about establishing an SO. Spending time up front identifying experienced advisors will help to minimize the legal fees and time associated with starting and running an SO, which can be substantial.

**Parent organizations may have high minimum levels needed to establish a supporting organization, and may charge ongoing administrative and management fees.** Many parent organizations require that SOs have a minimum of \$1 million or more in assets to justify the significant costs and expertise needed to manage an SO program. While this minimum may not be prohibitive for a family considering the establishment of a private foundation, it may lead other families to consider the use of a donor-advised fund or some other option (whose minimums are typically much lower). One observer notes that the size of the SO may also affect the attention and deference it receives from the parent organization. Finally, parent organizations typically charge annual administrative and management fees—usually between one-half to 2 percent of assets—that may be as much as the costs required to run a private foundation.

**Supporting organizations are separate legal entities.** As such, they must apply for tax-exempt status, file detailed annual tax returns that are subject to public inspection, and conduct regular board meetings. For families unwilling to take on these ongoing and potentially time-consuming activities, a donor-advised fund or other vehicle may be more appropriate.

**Supporting organizations limit the types of grants and organizations that may be funded.** SOs are required to support either the organizations named in their founding documents, or the specific causes of those organizations, limiting the types of grants that can be made by the SO. (On the other hand, this may well be attractive for those donors looking to control the types of grants that are made in the future.)

Identifying an appropriate parent organization is not always a simple task, depending on the geographic location and grantmaking interests of a particular family.

**Families looking to establish a parent-subsidiary relationship must identify a parent organization that is a good match for the family in terms of values, approach, and grantmaking focus.** Because families must be willing to share decision-making responsibilities with non-family trustees, it is crucial that

they find a parent organization who understands and appreciates their interests, and who is able to give them the advice and support desired. Identifying an appropriate parent organization is not always a simple task, depending on the geographic location and grantmaking interests of a particular family.

**Changes in the parent organization may affect the management and service provided to the supporting organization.** For an SO that establishes a parent-subsidiary relationship with a PC, staff downsizing or personnel changes sometimes result in decreased levels of service or an unclear relationship with the parent organization. Prior to confirming the choice of parent organization, the family should ensure that it is comfortable with the stability of the organization and its leadership, and that the founding documents of the SO provide the family with some protection regarding the ongoing arrangement between the two organizations. (Note: it is possible to change parent organizations if necessary, but may be costly and time-consuming.)

**The IRS has expressed ongoing concern about the activities of supporting organizations.** Some observers feel that the IRS is likely to closely scrutinize applications for Type III supporting organizations that do not choose the parent-subsidiary model with a specified public charity. There have been previous conversations regarding the use of supporting organizations to circumvent the rules governing private foundations, including a prominent article in the *Wall Street Journal*. Families that are less interested in supporting their named PCs, and more interested in functioning with full autonomy in the way that private family foundations do, would be wise to review these past discussions. The IRS has spent many hours considering the potential for abuse in supporting organizations, and families are advised to steer clear of any activity or arrangement that could be interpreted as running afoul of existing regulations.

## CONCLUSION: DETERMINING IF A SUPPORTING ORGANIZATION IS RIGHT FOR YOU

Supporting organizations are an appropriate option for many entrepreneurial and focused donors and their families. SOs provide a variety of advantages not available to private foundations, in return for giving up a small portion of control over the SO's activities. Supporting organizations can be complicated and relatively expensive to establish and maintain, and it is important that families consider these challenges carefully prior to establishing an SO.

Families may choose to establish a supporting organization when:

- They have access to an experienced advisor to help navigate the rules and regulations of SOs;
- The assets being donated are significant enough to justify a stand-alone organization;
- Legal control of the organization is not of primary interest to the family;
- Obtaining the largest charitable tax deduction and/or donating closely held stock or some other specialty asset is of primary interest to the family;

- The family has identified the organizations and/or causes that it wishes to support, and these named PCs are willing to serve in this role; and
- The family has reviewed other key options and is confident that an SO is the most appropriate vehicle.

This *Passages* issue paper has presented an overview of the options and opportunities of the supporting organization vehicle, as well as a description of the key challenges associated with SOs. We look forward to your stories and feedback regarding these and other *Passages* topics.

### ADDITIONAL SELECTED RESOURCES

"Family Charitable Giving: Private Foundations Versus Supporting Organizations," by June Klaassen and Constance J. Fontaine, *Journal of Financial Service Professionals*, May 1999.

<http://www.amercoll.edu/courses/faculty/publications/familygift599.pdf>

*Family Philanthropy and Donor-Advised Funds*, by Joseph Foote, National Center for Family Philanthropy, 2000.

<http://www.ncfp.org/publications-excerpt-donoradvisedfunds.html>

"How to Entice Your Entrepreneurial Donors," by Gerald B. Treacy Jr., February 1994, *Planned Giving Today*. Available online at:

[http://www.pgtoday.com/PGT/Articles/how\\_to\\_entice\\_your\\_entrepreneurial\\_donors.htm](http://www.pgtoday.com/PGT/Articles/how_to_entice_your_entrepreneurial_donors.htm)

"Public Charity Classification and Private Foundation Issues: Recent Emerging Significant Developments," by Ron Shoemaker and Bill Brockner. [http://www.irs.gov/prod/bus\\_info/eo/topicp00.pdf](http://www.irs.gov/prod/bus_info/eo/topicp00.pdf)

"The SO Trend: How to Succeed in Charity Without Really Giving," by Monica Langley, *Wall Street Journal*, May 29, 1998, pg. 1.

"Supporting Organizations," by Christopher R. Hoyt, Chapter 8 of *Legal Compendium for Community Foundations*, Council on Foundations, 1996.

"Supporting Organizations: A Good Alternative to Private Foundations," by Gerald B. Treacy, Jr., *Estate Planning*, January 1997, Vol. 24, No. 1, pgs. 17-21.

"Supporting Organizations: A Primer," by MacKenzie Canter III.

<http://www.exempttaxlaw.com/fsl5cs/articles/articles16.asp>

"Supporting Organizations: Getting Past the Mythology," by Gerald B. Treacy Jr., *Planned Giving Today*, October 1999.

[http://www.pgtoday.com/PGT/Articles/supporting\\_organizations\\_getting\\_past\\_the\\_mythology.htm](http://www.pgtoday.com/PGT/Articles/supporting_organizations_getting_past_the_mythology.htm)

"Supporting Organizations to Community Foundations: A Little-Used Alternative to Private Foundations," by Rochelle Korman and William F. Gaske, *The Exempt Organization Tax Review*, December 1994, Vol. 10, No. 6, pgs. 1327-1334.

"The Emergence of 'Venture Philanthropy' Raises New Tax Issues," by LaVerne Woods, *Taxation of Exempts*, September/October 2001.

"Weighing the Alternatives to Private Foundations," by Robert A. Boisture and Lloyd H. Mayer, *Journal of Taxation of Exempt Organizations*, May/June 2000.

<http://www.caplindrysdale.com/db30/cgi-bin/pubs/Weighing%20the%20Alternatives.pdf>

"What are the Distribution Requirements for Type 3 Supporting Organizations?" by Charitable Trust Administration Company.

<http://www.ctacadmin.com/CTAC/faqs.htm>

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By Jason C. Born

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#### WITH SPECIAL THANKS

The National Center gratefully acknowledges J.P. Morgan's generous contribution that helps make the National Center's *Passages* series possible. Our development of new information and resources for donors, their families, and their advisors depends on both the general and project support of funders who share our interest in encouraging and advancing family giving.

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- We value the personal acts of generosity that inspire private philanthropy, respecting both the issues of privacy and public trust that attend the decision to give.
- We value the pursuit of excellence in philanthropy.
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