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Taxonomy of Private Foundation Grantees

by Ed Chaney
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Agenda

- Changes to Form 990-PF
 - Compliance Considerations for Foundation Status
- 501(c)(3) Grantee Taxonomy
- Determining Foundation Status
- Other Considerations

Changes to 2013 990-PF

Beginning with 2013 990-PF filings, the IRS now requires the use of certain codes to indicate the “foundation status” of each grantee.

Foundation Status of Recipient

Use the following codes:

NC	Non-charity (not 501(c)(3))
PF	Private non-operating foundation (section 509(a))
POF	Private operating foundation (section 4942(j)(3)) other than an EOF
EOF	Exempt operating foundation (section 4940(d))
PC	Public charity described in section 509(a)(1) or (2)
SO-DP	Type I, type II, or type III functionally integrated supporting organization if a disqualified person of the private foundation controls the supporting organization or a supported organization (sections 509(a)(3) and 4942(g)(4))
SO I	Type I supporting organization (sections 509(a)(3) and 509(a)(3)(B)(i)) other than an SO-DP
SO II	Type II supporting organization (sections 509(a)(3) and 509(a)(3)(B)(ii)) other than an SO-DP
SO III FI	Functionally integrated type III supporting organization (sections 509(a)(3), 509(a)(3)(B)(iii), and 4943(f)(5)(B)) other than an SO-DP
SO III NFI	Non-functionally integrated type III supporting organization (sections 509(a)(3), 509(a)(3)(B)(iii), and 4943(f)(5)(B))
TPS	Testing for public safety organization (section 509(a)(4))

Compliance Considerations for Grantee Foundation Status

- Long standing law regulates private foundation grant making; in addition, the Pension Protection Act of 2006 tightened rules pertaining to grants to supporting organizations.
- Greater disclosure = increased enforcement regarding:
 - Section 4945 taxable expenditures
 - Section 4942 qualifying distributions



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Private Foundation Excise Taxes

Private foundations must abide by certain restrictions contained in Section 42 of the Internal Revenue Code of 1986, as amended, including:

- Section 4941 prohibition on self-dealing,
 - Section 4942 requirements for annual distributions,
 - Section 4943 limitations on excess business holding,
 - Section 4944 rules for jeopardy investments, and
 - Section 4945 taxable expenditures.
- Violations of these rules can result in stiff penalties on the foundation and its managers.

Section 4945: Taxable Expenditures

Section 4945 imposes penalties on certain expenditures by private foundations, including, but not limited to, grants to an organization unless:

- (A) such organization is
 - a 509(a)(1) or 509(a)(2) public charity,
 - a Type I or II or a functionally integrated Type III supporting organization, unless a disqualified person of the private foundation grantor directly and indirectly controls the supporting organization or one of its supported organizations, or
 - an exempt operating foundation, or
- (B) the private foundation exercises expenditure responsibility with respect to such grant

Section 4942: Qualifying Distributions

Generally, Section 4942 requires a private foundation to distribute or spend at least 5% of the aggregate fair market value of the foundation's assets (excluding exempt-use assets) on "qualifying distributions," which do not include:

(A) contributions to:

- a private non-operating foundation, or
- an organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation, unless the private foundation and the grantee follow certain "flow through" procedures;

(B) payments to:

- A Type III non-functionally integrated supporting organization
- Any other type of supporting organization (Type I, II, or III functionally integrated) if a disqualified person of the private foundation grantor directly and indirectly controls the supporting organization or one of its supported organizations.

Practically speaking...

- Foundations should verify 501(c)(3) and foundation status and whether there are any potential issues with respect to control by the foundation and its disqualified persons;
- Of the 1.4 million 501(c)(3) organizations currently registered with the IRS, the vast majority are public charities. (Internal Revenue Service, Exempt Organizations Business Master File (2014, Jun), The Urban Institute, National Center for Charitable Statistics, <http://nccsdataweb.urban.org/>)
- Special care is needed for supporting organizations due to regulatory complexities (less than 24,000)

Taxonomy of 501(c)(3) organizations

The world of Section 501(c)(3)s is divided into two general categories:

1. Private Foundations (which can be “operating” and “non operating”), and
2. “Public Charities” described in Section 509(a).

Generally, the law favors public charities (Chapter 42 excise taxes and charitable deduction limits) and, to some extent, private operating foundations.

Private Foundations

Generally, private foundations receive their support from only a few sources; as a result, they are more heavily regulated.

- Non-Operating Foundations: primary function = grant making
- Operating Foundations: primarily conduct their own charitable programs; receive some favorable treatment.
 - Grants from private foundations are considered qualifying distributions (unless controlled by the grantor); however, expenditure responsibility is still required.
 - An “Exempt Operating Foundation” is a private operating foundation that meets certain requirements, including being publicly supported for ten years
 - Grants from private foundations are considered qualifying distributions (unless controlled by the grantor); in addition, expenditure responsibility is **not** required.

Public Charities

- Public charities receive funding from a broader public base than their private foundation counterparts or have other indicia of public accountability.
- A charity must fall into one of four categories under 509(a) to be considered a public charity.

509(a)(1) & 509(a)(2)

- 509(a)(1): Most “50% limitation” organizations, including churches, schools, hospitals, organizations that benefit certain state colleges and universities, governmental units, and organizations that meet a donative public support test.
 - Note, supporting organizations, 509(a)(2) organizations, and private operating foundations are also 50% limitation organizations, but are not considered 509(a)(1) public charities.
- 509(a)(2): Organizations that meet a public support test tailored for significant revenue from activities related to their exempt purposes.

509(a)(3) Supporting Organizations

Supporting organizations are considered public charities by virtue of their relationship to one or more public charities described in Section 509(a)(1) and 509(a)(2). They fall into three categories based on their relationship to their supported organizations:

- Type I: Similar to a parent/subsidiary relationship
- Type II: Similar to corporate sibling relationship
- Type III: Loosest connection; e.g. some board overlap or representation but not a majority.
 - Disfavored form of SOs.
 - Moreover, there are two sub-categories of Type III SOs: functionally integrated and non-functionally integrated.
 - Generally, a Type III functionally integrated organization cannot be a fundraising or grant making vehicle for its supported organization; it must directly operate a program.

509(a)(4) Testing for Public Safety

- Organizations that perform testing for the public safety
- There are only 51 currently registered with the **IRS** (Internal Revenue Service, Exempt Organizations Business Master File (2014, Jun), The Urban Institute, National Center for Charitable Statistics, <http://nccsdataweb.urban.org/>)
- Grants from private foundations require expenditure responsibility

Determining Grantee Classification

Generally, private foundations can rely on the IRS:

- Determination letter (should verify that it is still effective)
- EO Select Check (Pub 78) (<http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check>): database of registered charities; however it does not distinguish among the different types of public charities.
- EO Business Master File (<http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Business-Master-File-Extract-EO-BMF>): provides more detailed information on exempt organizations, including foundation status.
- Foundations should keep electronic or hard copies of reports.

Determining Grantee Classification

Generally, private foundations can rely on the third party providers

- E.g.: [Guidestar](#) (premium service) or commercial providers (BNA, Lexis Nexis, Foundation Source)
- Providers report must include grantee's name, EIN, and foundation status, a statement that the information is from the most up to date BMF and the BMF extract revision date, and the date and time the information was provided. Grantors must keep an electronic or hard copy of the report.
- A foundation cannot rely on databases or a third party if it has knowledge that the grantee's status has been revoked prior to public notice, or it was responsible for or was aware of an act that caused a revocation or change in classification.

Special Rules for Grants to Supporting Organizations

- Many supporting organizations have not been classified by the IRS as a Type I, II, or III (or whether a Type III is functionally integrated); as a result, the BMF or third parties may not provide adequate information.
- In such case, a private foundation can rely on an opinion of counsel or certain representations from the grantee as to whether it is a Type I, II, or III. A review of additional documents may be necessary.

Other Considerations

- Churches
- Governmental Organizations
- Group Exemptions
- Similar Rules for Donor Advised Funds
- Different/additional considerations for foreign grantees or grants to non-charities
- Earmarking



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Pop Quiz

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Questions?

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