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IRS Takes Dim View of Supporting Organizations

By Bruce R. Hopkins

Some Section 501(c)(3) organizations are classified as public charities by virtue of being a "supporting organization" of another public charity or charities. This requires a close relationship with another organization, most commonly through overlapping boards.

The Internal Revenue Service (IRS), however, is not fond of supporting organizations, sometimes going to great lengths to thwart their use. Occasionally, the IRS is aided by the courts, particularly the U.S. Tax Court.

The type of supporting organization the IRS most favors is the parent-subsidiary model. The supported organization controls the supporting organization, such as by interlocking directorates.

The supporting organization least favored by the IRS is the one that operates *in connection with* a supported organization. Here, the relationship is founded on the extent of program services provided by the supporting entity to, and relied on by, the supported entity.

Meeting the Tests

A supporting organization that seeks to qualify as the second of these types is required to satisfy a *responsiveness* test, which is designed to ensure that the supporting organization is responsive to the needs of the supported organization.

An *integral part* test seeks to ensure that the supporting organization maintains a significant involvement in the operations of the supported organization and that the supported organization is dependent on the supporting organization for the support.

The responsiveness test requires an overlap of at least one trustee, director, or officer. The supported organization must have a *significant voice* in the investment policies of the supporting organization, as well as in the timing and recipients of grants made by the supporting organization. The test may be met by creating the supporting organization as a charitable trust.

The integral part test may be met when the supporting organization engages in activities for or on behalf of the supported organization. Or, the organization may make payments of substantially all its income to, or for the use of, the supported organization.

Tax Court Upholds IRS

Except for the involvement of the supporting organization, the activities involved would normally be engaged in by the supported organization. The IRS often contends that the support of the ostensible supporting organization is inadequate. Recently, the Tax Court upheld this IRS view (*Lapham Foundation, Inc. v. Commissioner*).

Attentiveness requires that the support must be sufficient to ensure the attentiveness of the supported entity. The court concluded in this case that the foundation's proposed grants to the would-be supported organization did not "rise to the requisite level" of support.

In another recent case, the Tax Court held that an organization could not qualify as a supporting organization because it failed to meet the integral part test (*Christie E. Cuddeback and Lucille M. Cuddeback Memorial Fund v. Commissioner*). The IRS contended that the fund's activities were not substantial and that loss of the fund's support would not cause the supported organization to interrupt or discontinue its program.

There are lessons to be learned here. When using a supporting organization, try to avoid the operated *in connection* with type. Otherwise, pay attention to the integral part test. Be prepared for an attack by the IRS contesting more than one element of that test. If litigation is necessary, do not expect much relief from the Tax Court.

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