

March 28, 2013

Via Electronic Mail

Preston J. Quesenberry
Stephanie N. Robbins
Office of Associate Chief Counsel (Tax-Exempt and Government Entities)
Internal Revenue Service
1111 Constitution Avenue NW.
Washington, DC

Re: Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated; REG 155929-06; 77 Federal Register 76426, 76382 (December 28, 2012).

Dear Mr. Quesenberry and Ms. Robbins:

The American Bankers Association welcomes this opportunity to comment on the Internal Revenue Service's (IRS) final and temporary rules governing Type III supporting organizations. Many ABA member banks and trust companies act as trustees to Type III supporting organizations that are established as trusts (Type III Charitable Trusts) and would be affected by the rules. We appreciate the improvements that the IRS has made upon the proposal in the final and temporary rules, but we still would like to comment on certain concerns of bank fiduciaries.

Summary of Final and Temporary Rules

The Internal Revenue Code (Code) defines a Type III supporting organization as a public charity organized and operated for the benefit of one or more publicly supported charitable organizations. Type III supporting organizations must fulfill certain requirements to keep their status, including being responsive to the needs of the supported organization (Responsiveness Test) and maintaining a significant involvement in the operations of the supported organization (Integral Part Test).

Pursuant to the Pension Protection Act of 2006 (Act), the final and temporary rules, among other things, (1) eliminate the alternative Responsiveness Test for Type III Charitable

Trusts, thereby subjecting them to the “significant voice” requirements; (2) require a payout distribution for non-functionally integrated Type III supporting organizations in order to satisfy the Integral Part Test; and (3) require certain notifications and communications to the supported charities.

Responsiveness Test

After the Act eliminated the alternative Responsiveness Test,¹ Type III Charitable Trusts by default became subject to the existing “significant voice” requirement in the regulations. Under this requirement, the charitable trust must maintain a close and continuous relationship with its supported organizations, as well as give the officers, directors, or trustees of the supported organization “a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making grants, and the selection of grant recipients by such supporting organization, and in otherwise directing the use of the income or assets of the supporting organization.”²

The final and temporary rules include a revised example describing when a charitable trust meets the test. We applaud the IRS for specifically allowing bank trustees to meet telephonically with the beneficiaries, as opposed to requiring in person meetings.

Despite the improved example and as we have noted in past letters,³ we continue to urge the IRS to include language in the regulation explicitly stating that the beneficiaries do not have “control” over the investments of the Type III Charitable Trust. The “significant voice” requirement is not mandated by section 509 of the Code, but it is a regulatory implementation of the statutory requirement to be “operated in connection with one or more” supported charitable organizations. In other words, the IRS could amend its “significant voice” requirement as it applies to Type III Charitable Trusts so that it recognizes how trusts administered under a fiduciary duty by trustees may differ from other forms of supporting organizations.

¹ Pension Protection Act of 2006, Section 1241 (c), P.L. 109-280.

² 26 CFR 1.509(a)-4(i)(3)(iii).

³ ABA Letters to the IRS, December 29, 2009 and October 31, 2007.

The inherent problems of applying the “significant voice” test to Type III Charitable Trust are highlighted by the difficulty of dealing with trusts that have specific provisions governing the “investment policies of the supporting organization, the timing of grants, the manner of making grants, and the selection of grant recipients...[and] the use of the income or assets of the supporting organization.” ABA is encouraged that the IRS will continue considering the best approach for these not uncommon Type III Charitable Trusts.

Integral Part Test and the Payout Rules

Under the final and temporary rules, a Type III supporting organization may either qualify as a functionally integrated or a non-functionally integrated supporting organization. A functionally integrated supporting organization is one that either (1) engages in activities which directly further the exempt purposes of the supported organizations, and but for the involvement of the supporting organization, the supported organization would normally do those activities; or (2) is the parent of the supported organization. A non-functionally integrated supporting organization is one that cannot meet the above test but can satisfy a distribution requirement and an attentiveness requirement. Because a trustee on behalf of the trust typically only administers the trust, invests its assets, and distributes its income and principal, in most circumstances a Type III Charitable Trust would be considered a non-functionally integrated supporting organization.

Under the temporary distribution requirement, a non-functionally integrated supporting organization must distribute annually at least greater of 85 percent of the supporting organization’s adjusted net income of the preceding the tax year or its “minimum asset amount.” Generally, the minimum asset amount is 3.5 percent of the aggregate fair market value of all of its assets in the preceding tax year.

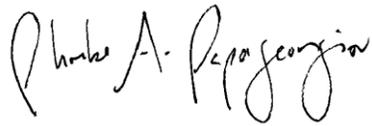
We thank the IRS for lowering the payout requirement from the 5 percent in the proposed rule to 3.5 percent in the temporary rule, but would like to raise one matter that can make the distribution requirement even more flexible and helpful for Type III supporting organizations and their supported organizations. In particular, the IRS notes in the release that it will consider whether to allow “program-related investments” (PRI) to count toward the satisfaction of the distribution requirement. Currently, private foundations are able to take advantage of this authority to satisfy their distribution requirements under section 4942. Given their apparent

usefulness to private foundations, we cannot see any reason why Type III supporting organizations should not also be allowed to count PRIs toward their new distribution requirements, thereby encouraging such useful and efficient investments.

Conclusion

ABA appreciates this opportunity to comment on the Type III supporting organization final and temporary rules. We urge the IRS to consider the particular constraints that bank trustees to Type III Charitable Trusts face, especially if the terms of the trust document dictate the timing and the amount a stated beneficiary may receive. We also ask that the IRS allow PRIs to count toward the distribution requirement for Type III supporting organizations.

Sincerely,

A handwritten signature in black ink that reads "Phoebe A. Papageorgiou". The signature is written in a cursive, flowing style.

Phoebe A. Papageorgiou
Senior Counsel II