

# Memorandum

## Final Regulations Regarding Requirements for Type I and Type III Supporting Organizations

November 6, 2023

The Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “IRS”) published final regulations (the “Final Regulations”) concerning organizations described in section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”), and classified as supporting organizations within the meaning of Code section 509(a)(3). The Final Regulations put into effect proposed regulations issued on February 19, 2016 (the “2016 Proposed Regulations”) and are effective as of October 16, 2023. The Final Regulations are relevant both for supporting organizations themselves, as well as for private foundations and public charities which sponsor donor-advised funds that may wish to make grants to supporting organizations.

The Final Regulations can be found [here](#).

### I. Background: Supporting Organizations

An organization described in Code section 501(c)(3) is further classified as either a private foundation or a publicly supported organization (*i.e.*, a public charity).<sup>1</sup> To be classified as other than a private foundation, an organization must be described in Code section 509(a)(1), (2), or (3). A supporting organization described in Code section 509(a)(3) is not itself required to meet a public support test, but rather qualifies as a public charity by providing support to one or more public charities described in Code section 509(a)(1) or (2), which are each referred to as a “supported organization.”

To be described as a supporting organization in Code section 509(a)(3), an organization must satisfy the following four tests.

- **Organizational and Operational Tests:** A supporting organization must be organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more supported organizations—that is, it must satisfy the organizational test and operational test, respectively.
- **Relationship Test:** A supporting organization must be operated, supervised or controlled by, supervised or controlled in connection with, or operated in connection with one or more supported organizations—that

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<sup>1</sup> See Code section 509(a).

is, it must satisfy the relationship test.<sup>2</sup> Under the relationship test, a supporting organization must have one of three types of relationships with one or more supported organizations.<sup>3</sup>

- A “Type I” supporting organization is *operated, supervised, or controlled by* one or more supported organizations, in a relationship similar to that of a parent and subsidiary.<sup>4</sup>
- A “Type II” supporting organization is *supervised or controlled in connection with* one or more supported organizations, in a relationship similar to that of commonly-controlled entities.<sup>5</sup>
- A “Type III” supporting organization is *operated in connection with* one or more supported organizations.<sup>6</sup>
- **Disqualified Person Control Test:** A supporting organization must not be controlled directly or indirectly by any disqualified person other than foundation managers and one or more public charities described in Code section 509(a)(1) or (2)—that is, it must satisfy the disqualified person control test.<sup>7</sup>

The Pension Protection Act of 2006 (the “PPA”), modified certain requirements for supporting organizations, and the Final Regulations provide guidance on several aspects of the PPA changes not addressed by prior regulations.

Although the Final Regulations enact much of the 2016 Proposed Regulations without change, certain provisions have been revised to reflect comments received in response to the 2016 Proposed Regulations.

## II. The Final Regulations

### A. DEFINITION OF CONTROL FOR PURPOSES OF DISQUALIFIED PERSON CONTROL TEST

Type I and Type III supporting organizations are prohibited from accepting any gift or contribution (i) from any person (other than a public charity or an organization that is organized and operated exclusively for testing for public safety) who, alone or together with certain related persons, directly or indirectly controls the governing body of a supported organization of the Type I or Type III supporting organization, or (ii) from persons related to a person possessing such control (the “Control Persons”).<sup>8</sup> Treasury and the IRS previously expressly reserved on the definition of control for this purpose.<sup>9</sup>

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<sup>2</sup> See Code section 509(a)(3)(A).

<sup>3</sup> See Code section 509(a)(3)(B).

<sup>4</sup> See Code section 509(a)(3)(B)(i).

<sup>5</sup> See Code section 509(a)(3)(B)(ii).

<sup>6</sup> See Code section 509(a)(3)(B)(iii).

<sup>7</sup> See Code section 509(a)(3)(C).

<sup>8</sup> See Code section 509(f)(2) and Treas. Reg. § 1.509(a)-4(f)(5)(i). Related persons are family members and 35 percent controlled entities.

<sup>9</sup> The Preamble to the Final Regulations (the “Preamble”) states that, in the Treasury decision whereby Treasury and the IRS adopted final regulations on other PPA changes in December 2012 (the “2012 Treasury Decision”), Treas. Reg. § 1.509(a)-4(f)(5)(ii), titled “Meaning of control,” was reserved for future proposed regulations.

The 2016 Proposed Regulations proposed defining “control” consistently with the definition of control relating to the disqualified person control test applicable to the management of supporting organizations. The Final Regulations put into place, with minor additions for clarity, the definition of “control” set forth in the 2016 Proposed Regulations.

Pursuant to the Final Regulations, control exists for purposes of the prohibition on accepting contributions from controlling donors if one or more Control Persons may require or prevent the governing body of the supported organization from performing any act that significantly affects its operations.<sup>10</sup> More specifically, the governing body of a supported organization will be considered to be controlled directly or indirectly by one or more Control Persons if (i) the voting power of the Control Persons is 50 percent or greater than the total voting power of such governing body or (ii) one or more Control Persons have the right to exercise veto power over the actions of the governing body of the supported organization.<sup>11</sup> The Final Regulations make clear that even if the Control Persons do not have control by virtue of holding 50 percent or more of the voting power or a veto power, all pertinent facts and circumstances will be taken into consideration in determining whether control exists.<sup>12</sup>

## B. NOTIFICATION REQUIREMENT

As part of satisfying the relationship test, Type III supporting organizations must provide to each supported organization, for each taxable year, such information as may be required to ensure that the supporting organization is responsive to the needs or demands of the supported organizations.<sup>13</sup> It was previously required that the notification be transmitted by the last day of the fifth calendar month following the close of “that taxable year,” which created ambiguity as to which organization’s taxable year—the supported or the supporting—was relevant.<sup>14</sup>

The Final Regulations adopt the clarification contained in the 2016 Proposed Regulations that the supporting organization must deliver the required documents to each of its supported organizations by the last day of the fifth month after the end of the taxable year of the supporting organization for which it is reporting.<sup>15</sup> The report must

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<sup>10</sup> See Treas. Reg. § 1.509(a)-4(f)(5)(ii).

<sup>11</sup> See *id.*

<sup>12</sup> See *id.* One commenter recommended excluding from the definition of control the control that a parent supporting organization exercises over its supported organizations for purposes of allowing controlled supported organizations to accept contributions from the parent supporting organization. Treasury and the IRS declined to adopt this recommendation on the grounds that Congress in Code section 509(f)(2) created an exception for 509(a)(1) and (2) public charities and 509(a)(4) public safety testing organizations, but did not extend such exception to 509(a)(3) supporting organizations.

<sup>13</sup> See Code section 509(f)(1)(A).

<sup>14</sup> See Prior Treas. Reg. § 1.509(a)-4(i)(2)(iii) (prior to amendment by TD 9981, Oct. 13, 2023). The Preamble states that the 2016 Proposed Regulations proposed changes intended to reduce confusion surrounding the due date of the required notification while not substantively changing the due date.

<sup>15</sup> See Treas. Reg. § 1.509(a)-4(i)(2)(iii).

include a brief narrative description of the support provided and sufficient financial detail for the recipient to identify the types and amounts of support being reported.<sup>16</sup>

### C. RESPONSIVENESS REQUIREMENT

As part of satisfying the relationship test, Type III supporting organizations must be “responsive to the needs or demands of a supported organization.”<sup>17</sup> To meet the responsiveness test, a supporting organization must satisfy two requirements: (i) the relationship requirement, under which the officers, directors, or trustees of the supporting and supported organizations must maintain one of three specified relationships, and (ii) the significant voice requirement, under which the officers, directors, or trustees of the supported organization must have a significant voice in the investment policies, grantmaking activities, and general direction of use of income or assets of the supporting organization.<sup>18</sup>

The Final Regulations adopt the revision proposed in the 2016 Proposed Regulations requiring a supporting organization to be responsive to the needs and demands of every one of its supported organizations to meet the responsiveness test.<sup>19</sup> The Final Regulations also attempt to address concerns about potential administrative burdens by adopting the new example included in the 2016 Proposed Regulations, which demonstrates one way in which a Type III supporting organization with multiple supported organizations may satisfy the responsiveness test in a cost-effective manner.<sup>20</sup>

### D. INTEGRAL PART TEST—FUNCTIONALLY INTEGRATED TYPE III SUPPORTING ORGANIZATIONS

Certain regulatory rules applicable to a Type III supporting organization vary depending on whether it is “functionally integrated” with its supported organizations.<sup>21</sup> Whether a Type III supporting organization is classified as functionally integrated or non-functionally integrated depends on how the organization meets the “integral part” component of the relationship test each taxable year.<sup>22</sup> To meet the integral part test as a functionally integrated Type III supporting organization, a Type III supporting organization must (i) engage in activities substantially all of which directly further the exempt purposes of one or more supported organizations

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<sup>16</sup> See Treas. Reg. § 1.509(a)-4(i)(2)(i)(A).

<sup>17</sup> See Treas. Reg. § 1.509(a)-4(i)(3)(i).

<sup>18</sup> See Treas. Reg. § 1.509(a)-4(i)(3)(ii) and (iii).

<sup>19</sup> See Treas. Reg. § 1.509(a)-4(i)(3)(i). One commentator suggested requiring that Type III supporting organizations be responsive to only a subset of their supported organizations to ease administrative burdens that would effectively limit the total number of organizations that a supporting organization could support. Treasury and the IRS declined to adopt this recommendation on the grounds that the distinguishing characteristic of and basis for the public charity classification of Type III supporting organizations is that they are responsive to and significantly involved in the operations of their supported organizations, and limiting the responsiveness requirement to a subset of supported organizations may result in the necessary oversight and accountability being present for less than all of the supporting organization’s operations.

<sup>20</sup> See Treas. Reg. § 1.509(a)-4(i)(3)(iv).

<sup>21</sup> See Code section 4943(f)(5)(B).

<sup>22</sup> See Treas. Reg. § 1.509(a)-4(i)(1)(iii).

and which, but for the involvement of the supporting organization, would normally be engaged in by the supported organizations, (ii) be the parent of each of its supported organizations, or (iii) support a governmental supported organization.<sup>23</sup>

#### i. Parent of a Supported Organization.

The Final Regulations reorganize and clarify the requirements for a Type III supporting organization to qualify as the parent of each of its supported organizations under the integral part test.<sup>24</sup> As drafted in the 2016 Proposed Regulations, there are three requirements: (i) the supporting organization and supported organization(s) must be part of the same integrated system, (ii) the supporting organization must engage in “activities typical of the parent of an integrated system,” and (iii) a majority of each supported organization’s governing bodies (*i.e.*, its officers, directors, or trustees) must be appointed, directly or indirectly, by the supporting organization’s governing body.<sup>25</sup>

The Final Regulations remove the open-ended category of “activities typical of the parent of an integrated system” and specify that, to qualify as the parent of a supported organization, a supporting organization “must direct the overall policies, programs, and activities of the supported organizations.”<sup>26</sup> The Final Regulations also expand on the requirement that, as the parent of a supported organization, a Type III functionally integrated supporting organization must appoint or elect the supported organization’s governing bodies. In addition to this power to appoint or elect, the Final Regulations specify that a parent of a supported organization must also have the power to remove or replace members of a supported organization’s governing bodies, or otherwise have “an ongoing power to appoint or elect with reasonable frequency.”<sup>27</sup> This addition formalizes an existing interpretation set forth by Treasury and the IRS in the preamble to the 2016 Proposed Regulations.

The Final Regulations also clarify that a supporting organization may have the requisite power to appoint or remove members of a supporting organization’s governing bodies even if such power is exercised indirectly through an intermediary subsidiary over which it also has control.<sup>28</sup> The Final Regulations include an example of such a structure.<sup>29</sup> The possibility of this arrangement was also posited in the preamble to the 2016 Proposed Regulations, which interpreted the use of “directly or indirectly” in the 2016 Proposed Regulations to encompass these multi-tiered structures.

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<sup>23</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(i).

<sup>24</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(iii).

<sup>25</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(iii), as drafted in the 2016 Proposed Regulations.

<sup>26</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(iii)(A)(2).

<sup>27</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(iii)(A)(3).

<sup>28</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(iii)(B).

<sup>29</sup> See *id.*

## ii. Supporting a Governmental Supported Organization.

By adopting the 2016 Proposed Regulations, the Final Regulations codify how a Type III supporting organization may qualify as functionally integrated through its support of a governmental supported organization. Treasury and the IRS reserved addressing this issue when regulations concerning the integral part test were adopted in December 2012.<sup>30</sup> In January 2014, the IRS issued a notice (the “2014 Notice”) containing interim guidance for supporting organizations of governmental supported organizations.<sup>31</sup> The 2016 Proposed Regulations expanded considerably on the 2014 Notice and, as adopted in the Final Regulations, provide a greater level of guidance and detail for supporting organizations who wish to qualify as functionally integrated through their support of governmental supported organizations.

Under the Final Regulations, a supporting organization may qualify as a Type III functionally integrated supporting organization if it meets the following requirements: (i) the supporting organization either supports only one governmental supported organization, or supports more than one governmental supported organization all of which operate within the same city, county, or metropolitan area or work in close coordination or collaboration with each other to conduct the activity the supporting organization supports, and (ii) a substantial part of the supporting organization’s activities directly furthers the exempt purposes of its governmental supported organization(s).<sup>32</sup> The Final Regulations also include a new example to clarify that the “substantial part” standard permits a Type III functionally integrated supporting organization of a governmental supported organization to make grants to its supported organization as a substantial part of its activities, even though making grants to the supported organization is not deemed to “directly further” the supported organization’s exempt purposes.<sup>33</sup>

The Final Regulations also clarify that, when determining whether a substantial part of a supporting organization’s activities directly further its governmental supported organization’s exempt purposes, the general test for determining functional integration will be applied (*i.e.*, all pertinent facts and circumstances will be taken under consideration).<sup>34</sup> The new example mentioned above is also intended to illustrate that a supporting organization that supports multiple governmental organizations may satisfy the substantial part test if more than a substantial part of its activities directly furthers the exempt purposes of at least one of its governmental supported organizations.<sup>35</sup> The Final Regulations also formalize the understanding, previously stated in the

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<sup>30</sup> See *generally* the preamble to the 2012 Treasury Decision.

<sup>31</sup> See Notice 2014-4, 2014-2 I.R.B. 274.

<sup>32</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(iv)(A).

<sup>33</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(v)(F).

<sup>34</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(iv)(D).

<sup>35</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(v)(F).

preamble to the 2016 Proposed Regulations, that a supported governmental organization will be understood to include all such organization's agencies, departments, and divisions.<sup>36</sup>

#### E. INTEGRAL PART TEST—NON-FUNCTIONALLY INTEGRATED TYPE III SUPPORTING ORGANIZATIONS

To meet the integral part test as a non-functionally integrated Type III supporting organization, the supporting organization must satisfy a distribution requirement by making a minimum amount of distributions to or for the use of one or more supported organizations each year.<sup>37</sup> The Final Regulations provide a number of clarifications on the computation of the distribution requirement, including the treatment of expenses and contributions from fundraising activities. The details of these aspects of the Final Regulations are not readily summarized and are beyond the scope of this update.

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For more information, please contact any member of our [Exempt Organizations Group](#):

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<sup>36</sup> See Treas. Reg. § 1.509(a)-4(i)(4)(iv)(B)(1).

<sup>37</sup> See Treas. Reg. § 1.509(a)-4(i)(5)(ii).