S Corporation Corner

Charitable Planning with S Corporation Stock—*Making It Work*

By Robert C. Walthall

Since 1998, charities have been able to own S corporation stock ("S stock"). However, the ownership of S stock by an exempt organization may result in either an unexpected tax burden or a liability rather than an asset for the charity. This author's recent experiences with several clients seeking to include gifts of S stock in their charitable planning well illustrated how challenging this planning objective can be.

The purpose of this column is four-fold: (1) draw attention to the unrelated business taxable income (UBTI) tax pitfall that exists when a charity owns S stock; (2) consider the tax factors for a charity using either a corporation or a trust to hold S stock; (3) use of a Code Sec. 509(a)(3) Type III "supporting organization" (SO) to reduce the UBTI tax; and (4) the possible use of an SO to reduce the excess business holdings tax pitfall that exists when a private foundation owns S stock.

Charities and the UBTI Tax. Charitable shareholders are not exempt from being taxed on their allocable share of income from their S corporation stock. A charity's share of S corporation income is treated as UBTI, which would be taxable income to the charity under Code Sec. 512(e). Similarly, if the charity sells the S stock, the gain would be subject to tax as UBTI. For those and other reasons, much has been written and discussed as to the best way for a charity to hold S corporation stock. These discussions usually focus on how to lower the effective tax rate paid by the charity on its share of the S corporation income. If the charity is a corporation, the tax on the S stock income is paid at corporate rates. If the charity is a trust, the tax on the S stock income is paid at trust rates.

The amount of a charity's UBTI liability, especially on its long-term capital gain income, will vary dramatically depending on whether the organization is a corporation or a trust.

Trust Tax Rates. A charitable trust pays the top 39.6-percent tax rate on ordinary income in excess of $12,150 in 2014. A charitable trust, however, generally will pay the same 20 percent (plus a 3.8-percent Obamacare tax) capital gains tax rate paid by individuals. Also, a charitable trust can deduct from UBTI its donations made to other charities up to the 30-percent/50-percent limitations applicable to individuals.

Corporation Tax Rates. A charity structured as a corporation generally pays a top 35-percent tax rate on ordinary income, but corporations have a longer run up the bracket as compared to a charitable trust. But a charity structured as a

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corporation can also pay a 35-percent tax rate on capital gains. Also, a charitable corporation is allowed to deduct only up to 10 percent of UBTI for donations made to other charities.

Corporations vs. Trusts and UBTI

In light of such divergent tax treatment generally, if the charity is expected to sell the contributed S stock or if there is a large built-in gain in the S corporation stock, then the charity should be structured as a trust to reduce the UBTI tax. Conversely, if the charity will likely retain the S stock for a longer period of time or if the built-in gain is not that significant, then the charity should be structured as a corporation to reduce the UBTI tax.

A charity set up as a corporation is entitled to a deduction for contributions made to another charity up to 10 percent of its taxable income. Funds expended in fulfilling the charity's own mission are not deductible for this purpose. This deduction would reduce the effective tax rate for the corporate charity on its UBTI by approximately 10 percent from 35 percent to 31.5 percent. If an operating charity has (or establishes) a supporting organization, it should be able to deduct the distributions made in support of its "charitable parent" or another charity.

[T]he ownership of S stock by an exempt organization may result in either an unexpected tax burden or a liability rather than an asset for the charity.

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Charities established as trusts are entitled to the same deduction limits as individuals. In general, the individual limitations allow deduction of up to 50 percent of adjusted gross income for donations of cash to a public charity (30 percent for donations to a private foundation). This means that a trust-formed supporting organization making grants to its charitable parent can reduce the effective tax rate on its UBTI by up to 50 percent.

If a trust-type supporting organization holding S stock receives sufficient cash from the S corporation to distribute at least 50 percent of its taxable income to its "supported organization," it can effectively cut its tax rate in half from 40 percent to 20 percent. The 50-percent reduction would apply to capital gains as well as ordinary income; the effective rate would be 10 percent instead of 20 percent. This is 35 percent less tax than the best possible results obtainable under the corporate rules for a corporate-type supporting organization. Also, the Code and regulations make it clear that distributions to the beneficiary of a trust are allowable as deductions in computing taxable income. The provisions for corporations are not quite as clear.

Another important factor for determining how a charity should hold S stock is the expected annual cash distributions to the charity S shareholder as a percentage of taxable income. Two examples well illustrate the best type of structure (corporation or trust) to hold the S stock. In each case, the business' taxable income is $200,000 and the charity is the sole shareholder. The first business distributes 40 percent of taxable income and the second business distributes 75 percent of taxable income.

Example 1. A corporate charity holding the S stock would receive $80,000 in cash and its tax would be $70,000. However, it can deduct up to 10 percent of taxable income for any contribution to its supporting charity (say $20,000). Accordingly, the taxable income would be $180,000 and its tax would be $63,000. If the charity had been organized as a trust, the entire $80,000 distribution would be remitted for taxes, thereby leaving nothing for a charitable contribution.

Example 2. If the business distributed 75 percent of its taxable income, a corporate charity holding the S stock would receive $150,000. Its tax would be $63,000 ($200,000 S income, less $20,000 charitable deduction x 35-percent tax rate). The supported charity would receive the net of $87,000. However, a charitable trust would produce a better result for charitable purposes. There would be a tax of $40,000 and a distribution by the charitable trust to charity of $110,000 out of the $150,000 distribution.

Use of Supporting Organization to Reduce UBTI. An SO is a separate corporation or trust that is classified as a public charity under Code Sec. 509(a)(3). It is a "friend of" a publicly supported charity. It is one of the few organizations that qualifies as a public charity without having to pass the public support test. It can, therefore, be classified as a public charity, even if there is only one donor. As discussed herein, a Type III SO has the least connected relationship with its supported charitable organization of any type SO. A Type III SO clearly offers some advantages for a charity owning S stock to reduce its UBTI tax.

Overview of Supporting Organizations

An SO is generally excluded from the definition of a private foundation and is, therefore, classified as a public charity, by virtue of its support of, and relationship with, the one or more public charities that it supports. An SO can be formed as a nonprofit corporation or as a charitable trust and is a separate and distinct legal entity from the charities it supports.

The Final Regulations adopted in 2012 and discussed herein clarify that the definition of "supported organization" includes (i) any supported public charity described by name in a supporting organization's articles of incorporation or (ii) any supported public charity not designated by name in the supporting organization's articles of incorporation if there has been a historical and continuing relationship between the supporting organization and the supported public charity and, by reason of the relationship, there has developed a substantial identity of interests between the two organizations.[1]

An SO is classified as a public charity and therefore generally is not subject to the strict and burdensome tax regime of potential excise tax penalties applicable to private foundations.[2] The specific excise taxes applicable to private foundations are:

(a) *Excise Tax on Investment Income*.[3] A private foundation is subject to a two-percent tax on its net investment income.

(b) *Excise Tax on Self-Dealing*.[4] Subject to certain exceptions, a private foundation cannot engage in any prohibitive "self-dealing" transactions with disqualified persons.

(c) *Excise Tax on Failure to Distribute Income*.[5] By the end of each fiscal year, a private foundation must make qualifying distributions in an amount equal to or greater than five percent of the aggregate fair market value of the foundation's investment assets, *i.e.,* assets that are not used directly to carry out the foundation's exempt purposes.

(d) *Excise Tax on Excess Business Holdings*.[6] A private foundation may own the stock and securities of a "business enterprise" only up to a permitted level, which is generally 20 percent of a corporation's voting stock less the amount of voting stock owned by the foundation's officers, directors, trustees or substantial contributors and their families.

(e) *Excise Tax on Jeopardy Investments*.[7] A private foundation cannot invest its funds in ways that could jeopardize the foundation's ability to carry out its charitable purposes.

(f) *Excise Tax on Taxable Expenditures*.[8] A private foundation cannot make tangible expenditures.

Qualifying as an SO. In order to qualify as an SO, the organization must meet each of the following three statutory requirements under Code Sec. 509(a)(3).[9]

1. The organization is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified publicly supported organizations.[10]
2. The organization must have one of three possible relationships with one or more publicly supported organizations which, depending on the type of relationship, results in the organization being known as a Type I, Type II or Type III SO. The three alternative types of relationships are where the SO is (i) "operated, supervised or controlled by" (Type I); (ii) "supervised or controlled in connection with" (Type II); or (iii) "operated in connection with" one or more publicly supported organizations (Type III).[11]
3. The organization must not be controlled directly or indirectly by one or more disqualified persons (as defined in Code Sec. 4946) other than foundation managers with respect to such organization and other than the one or more publicly supported organizations the organization supports.[12]

Background on and Advantages of Type III SOs

A Type III SO has the least connected relationship with its supported charitable organizations of any type of SO. It has its own independent board and, therefore, it is not subject to the control of the supported organization or its board members. There is a lower threshold of supported organization participation in a Type III SO's operations. The Type III SO's relationship with the supported organization is tested under the "operated in connection with" standard.

In order to meet the "operated in connection with" requirement, a Type III SO must meet a "responsiveness test" and an "integral part test." The responsiveness test generally requires that the SO be responsive to the needs or demands of one or more of its supported organizations. The integral part test is generally met by the Type III SO maintaining a significant involvement in the operations of one or more supported organizations that are dependent on the SO for the type of support which it provides.

The PPA made a number of significant changes to Type III SO status, and directed the Department of the Treasury

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and the IRS to issue regulations to provide such guidance for Type III SOs. After the enactment of the PPA, there was uncertainty as to whether existing Type III SOs, including charitable trusts, could continue to qualify as Type III SOs and what measures such entity should take in order to maintain their status as a post-PPA Type III SO tax regime.

In 2012 the Treasury issued both temporary and final regulations providing guidance on Type III SOs,[13] although the Preamble to the regulations indicates that additional guidance in this area is anticipated. The regulations clarify the requirements for Type III SO status that had been lacking under the statutory regime put in place under the PPA. The next part of this column addresses the requirements for an organization to qualify for Type III SO status in a post-PPA tax regime, as implemented by the temporary and final regulations issued by the Treasury and the IRS.

Requirements for Type III SO Under PPA and New Regulations

In order to be classified as a Type III SO, under the temporary and final regulations, the organization must:

1. Be organized and operated exclusively for the benefit of one or more specified domestic publicly supported organizations described in Code Sec. 509(a)(1) or (2).[14]
2. Meet both a "responsiveness test" and an "integral part test," with the nature of the integral part test dependent on whether the organization is functionally integrated or nonfunctionally integrated.
3. Not be controlled directly or indirectly by one or more disqualified persons (as defined in Code Sec. 4946) other than foundation managers with respect to such organization and other than the one or more publicly supported organizations the organization supports.
4. Meet annual notification requirements with respect to each of the one or more publicly supported organizations it supports.
5. Not receive contributions from persons with direct or indirect control of any supported organization.

Responsiveness Test. A SO must meet a "responsiveness test," so as to ensure that it is responsive to the needs or demands of a supported organization.[15] This is also commonly referred to as the "significant voice responsiveness test." To meet this test, (i) the Type III SO must have a specified relationship with a supported organization and (ii) by virtue of such relationship, the officers, the directors, or trustees of the supported organization must be considered to have a "significant voice" in the operations of the Type III SO.

Under the regulations, the Type III SO need meet the responsiveness test only with respect to at least one supported organization,[16] although the Preamble to the regulations states that the Treasury and the IRS intend to propose regulations requiring that a nonfunctionally integrated Type III SO meet the responsiveness test with respect to each of their supported organizations. Until such regulations are issued, however, the responsiveness test need be met with respect to one supported organization, regardless of the number of supported organizations of a Type III SO.

Requisite Relationship. A Type III SO has the requisite relationship with respect to a supported organization only if any of the following are satisfied:

1. one or more officers, directors or trustees of the SO are elected or appointed by the officers, directors, trustees or membership of the supported organization;
2. one or more members of the governing body of the supported organization are also officers, directors or trustees of, or hold other important offices in, the SO; or
3. the officers, directors or trustees of the SO maintain a close and continuous working relationship with the officers, directors or trustees of the supported organization.

Significant Voice Requirement. A Type III SO meets the significant voice requirement only if the officers, directors or trustees of the SO have a significant voice in:

1. the investment policies of the SO;
2. the timing of grants;
3. the manner of making grants; and
4. the selection of grant recipients by such SO, and in otherwise directing the use of the income or assets of the SO.[17]

Responsiveness Test for Charitable Trusts. Charitable trusts must meet the same responsiveness test applicable to all other Type III SOs.

The Preamble to the regulations states that as "a general matter, the Treasury Department and the IRS anticipate that charitable trusts will be able to demonstrate that they satisfy the responsiveness test in a variety of ways, and whether a supported organization has a close and continuous relationship with, or a significant voice in directing the use of the income or assets of, a supporting organization will be determined based on all the relevant facts and circumstances." The Preamble also indicates that the Treasury and the IRS intend to issue proposed regulations clarifying the responsiveness test in the context of a trust instrument that specifies the recipients, timing, manner and amount of grants.

Integral Part Test. Under the integral part test, the Type III SO must be either functionally integrated or nonfunctionally integrated. Functionally integrated Type III SOs are not subject to annual distribution

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requirements, while nonfunctionally integrated Type III SOs are just the opposite. A functionally integrated Type III SO meets the integral part test due to the activities of the organization—*i.e.,* by directly performing the functions of, or carrying out the purposes of, its supported organizations. A nonfunctionally integrated Type III SO meets the integral part test by virtue of distributing funds to a supported organization, not by conducting activities.

Functionally Integrated Type III SOs. A functionally integrated Type III SO is one that engages in activities substantially all of which directly further the exempt purposes of one or more supported organizations by performing the functions or carrying out the purposes of the supported organization and which, but for the involvement of the SO, would normally be engaged in by the supported organization.[18] The activities must be conducted by the SO itself, rather than by a supported organization.[19]

The regulations clarify that whether substantially all of an SO's activities directly furthers the exempt purposes of a supported organization will be determined on a facts and circumstances basis.[20]

Nonfunctionally Integrated Type III SOs. A separate integral part test must be met to qualify as a nonfunctionally integrated Type III SO. A nonfunctionally integrated Type III SO would include an SO whose activities consist of making distributions of money to the supported organization, as in the case of a charitable trust making distributions to designated charities. A nonfunctionally integrated Type III SO must meet both a minimum payout requirement[21] and an attentiveness requirement.[22]

Minimum Distribution Requirements of Nonfunctionally Integrated Type III SOs in a Post-PPA Tax Regime as Implemented by Regulations. In order to meet the integral part test, a nonfunctionally integrated Type III SO must distribute annually a "distributable amount" equal to the greater of (i) 85 percent of its adjusted net income (determined by applying the principles of Code Sec. 4942(f)) for the immediately preceding tax year) or (ii) 3.5 percent of the fair market value of its noncharitable use assets for the immediately preceding tax year,[23] determined by applying the principles applicable to private nonoperating foundations under Code Sec. 4942.[24] Distributions in excess of the annual distributable amount may be carried over for five subsequent years with the distributable amount in that later year first reduced by any excess amount carried over, with the oldest excess amount applied first.[25]

The amount of a distribution by a Type III SO to a supported organization includes the cash distributed or the fair market value of property distributed as of the date the distribution is made, determined solely on a cash basis.[26] The 2009 Proposed Regulations used language from the Treasury Regulation relating to the private foundation annual distribution requirement of Code Sec. 4942 to determine how a nonfunctionally integrated Type III SO computes the fair market value of its nonexempt-use assets in connection with determining its annual distributable amount.[27] The Treasury and the IRS determined that cross-referencing the specific Treasury Regulation section, rather than restating language found in that section, accomplished the same result and, therefore, the current proposed regulations include a cross-reference.[28] Although the Treasury and the IRS did not intend the change to result in any substantive changes from the 2009 Proposed Regulations, the new provisions relating to valuation of assets were issued as temporary and proposed regulations to provide opportunity for public comment.

[A Type III SO] has its own independent board and, therefore, it is not subject to the control of the supported organization or its board members.

Reg. §1.509(a)-4(i)(6) provides that distributions by the Type III SO that count toward its distribution requirement "shall include, but not be limited to" the following:

1. Any amount paid to the supported organization to accomplish the supported organization's exempt purposes.
2. Any amount paid to perform a direct activity of the supported organization, but only to the extent that such amount exceeds any income derived from such activity.
3. Any reasonable and necessary administrative expenses of the supported organization to accomplish its exempt purposes (which do not include investment-related expenses).[29]
4. Any amount to acquire an exempt-use asset.
5. Any amount set aside for a specific project that accomplishes the exempt purposes of a supported organization.

The Preamble clarifies that grants to organizations other than a supporting organization's supported organization do not count towards a nonfunctionally integrated Type III supported organization's distributable amount.

Attentiveness Requirements. To meet the attentiveness requirement, a nonfunctionally integrated Type III SO must distribute at least one-third of its annual distributable amount to one or more supported organizations that are attentive to the operations of the Type III SO and to which the Type III SO is responsive.[30] A supported organization

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is considered attentive to the operations of the Type III SO during a tax year if, in that year[31]:

1. the Type III SO distributes to the supported organization at least 10 percent or more of the supported organization's total support received during the supported organization's last tax year;
2. the amount of support received from the Type III SO is necessary to avoid the interruption of a particular function or activity of the supported organization. The support is considered necessary if the Type III SO or the supported organization earmarks the support for a particular program or activity of the supported organization, even if such program or activity is not the supported organization's primary program or activity, as long as such program or activity is at least a substantial one; or
3. based on all pertinent factors, including the number of supported organizations, the length and nature of the relationship between the supported organization and Type III SO, and the purpose to which the funds are put, the amount of support received from the Type III SO is a sufficient part of a supported organization's total support to ensure attentiveness.

Type III SOs Cannot be Controlled by Disqualified Persons. A Type III SO may not be controlled directly or indirectly by one or more disqualified persons, as defined in Code Sec. 4946, including substantial contributors; their family members; and corporations, partnerships or trusts in which interests of more than 35 percent is owned by disqualified persons.[32] A disqualified person does not include foundation managers or organizations, which are public charities under Code Sec. 509(a)(1) or (2).

Reg. §1.509(a)-4(j)(1) provides that an organization is considered controlled if the disqualified persons (other than those specifically excluded as indicated above), by aggregating their votes or positions of authority, "may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act." This control feature includes the right of any substantial contributor or his or her spouse to designate annually the recipients, from among the publicly supported organizations, of the income attributable to his or her contribution to the SO. Under the regulations, an SO is considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of such persons have the right to exercise veto power over the actions of the organization. An organization is permitted to establish to the satisfaction of the Commissioner that disqualified persons do not directly or indirectly control it.[33]

Annual Notification Requirement to Each Supported Organization. The following documents must be provided annually by all Type III SOs to each of its supported organizations whether functionally or nonfunctionally integrated:

1. a written notice to a principal officer[34] of the supported organization describing the type and amount of all of the support the SO provided to the supported organization during the SO's immediately preceding tax year;
2. a copy of the SO's most recently filed Form 990;
3. a copy of the SO's controlling governing documents, including its articles of incorporation, unless such documents have been previously provided and not subsequently amended and any by-laws, and any amendments to those documents.[35] The documents required for any tax year are required to be postmarked or electronically transmitted by the last day of the fifth calendar month following the close of that tax year (May 31 for calendar tax years).[36]

Excess Business Holdings Tax

A major problem for a private foundation in owning S stock is the Code Sec. 4943 excess business holdings tax. This Code section requires a private foundation to dispose of its excess interest in an S corporation if more than 20 percent of the S corporation's voting stock is owned by a combination of the private foundation, the donor, the donor's family, the donor's businesses and other designated persons. However, under Code Sec. 4943(c)(6), a private foundation is permitted to hold such excess stock for up to five years if it received the S stock by gift or bequest (or under Code Sec. 4943(c)(7), up to 10 years with an IRS extension). The 20-percent threshold can be increased under Code Sec. 4943(c)(2)(B) to 35 percent if someone other than a disqualified person has "effective control" over the S corporation. If a private foundation has excess business holdings, there is an initial tax of 10 percent on the value of the excess business holdings. If the private foundation does not dispose of the excess holding by the end of the tax year, it is subject to a punitive 200 percent tax on the excess value.

Subject to certain exceptions discussed below, a solution for a donor who would like to have a private foundation hold S stock is to establish an SO. The IRS has been fairly generous in letting donors establish SOs for the express purpose of avoiding the excess business holdings tax. However, certain SOs are treated as private foundations for the excess business holdings tax: these SOs are (i) a Type III SO other than a functionally integrated Type III

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SO; and (ii) a Type II SO if the Type II SO accepts a gift or contribution from a person described in Code Sec. 509(f)(2)(B). By comparison, Type I and other Type II SOs are exempt from the excess business holdings rules, provided they are not directly or indirectly controlled by one or more disqualified persons.[37]

Conclusion

The ability of charities to own S corporation stock creates opportunities for charities to participate in the most common form of small business. However, when advising clients seeking to include gifts of S stock in their charitable planning, it is necessary to be mindful of the various tax pitfalls that exists when a charity owns S stock. The interaction of the UBIT tax laws with the S corporation laws raises many potential complex issues for the donor and the charity. Taxes should never be the only consideration when planning for a potential gift of S stock to a charity. However, taxes must be given serious consideration by both the donor and the charity because of these tax pitfalls. It is important to consider the structure of the charitable organization in order to maximize the value of a charitable donation of S stock and minimize tax consequences to the charity.

ENDNOTES

1 Reg. §1.509(a)-4(a)(6).
2 Contributions to private foundations are subject to less favorable income tax treatment under Code Sec. 170. However, under the Pension Protection Act of 2006 (P.L. 109-280) (the PPA), Type III SOs that are nonfunctionally integrated and organizations making grants to such Type III SOs, are subject to certain private foundation rules. First, they are subject to the private foundation excess business holdings tax under Code Sec. 4943(f) (nonfunctionally integrated Type III SO). Second, they are subject to a special type of self-dealing prohibition under Code Sec. 4958.
3 Code Sec. 4940.
4 Code Sec. 4941.
5 Code Sec. 4942.
6 Code Sec. 4943.
7 Code Sec. 4944.
8 Code Sec. 4945.
9 Type III SOs are subject to additional requirements, other than those set forth in Code Sec. 509(a)(3), whereby they must annually provide certain information to each of their supported organizations, may not have any support organizations not organized in the United States, and may not accept donations from donors who control a supported organization.
10 Code Sec. 509(a)(3)(A).
11 Code Sec. 509(a)(3)(B).
12 Code Sec. 509(a)(3)(C).
13 T.D. 9605 Dec. 28, 2012. The Temporary Regulations (Temporary Reg. §1.509(a)-4T) address the annual distribution requirements for the category of Type III SOs that are considered "nonfunctionally integrated," as discussed hereinafter. Both the temporary and final regulations became effective on December 28, 2012.
14 Reg. §1.509(a)-4(f)(5). In the case of a Type III SO, the governing document must designate each of the specified supported organizations by name, except where there has been a historic and continuing relationship between the Type III SO and the publicly supported organization, and, by reason of such relationship, there has developed a substantiality of interest between such organizations. Reg. §1.509(a)-4(d)(1) and (d)(2)(iv).
15 Reg. §1.509(a)-4(i)(1)(ii).
16 Reg. §1.509(a)-4(i)(3)(i). A supporting organization meets the responsiveness test if it is responsive to the needs or demands of a supported organization.
17 Reg. §1.509(a)-4(i)(1)(iii).
18 Reg. §1.509(a)-4(i)(4)(i) and (ii). The only definition of a "functionally integrated Type III SO" in the Code is found at Code Sec. 4943(f)(5)(B), for purposes of subjecting Type III SOs to the excess business holdings rule of Code Sec. 4943 other than in a case of a functionally integrated Type III SO. Code Sec. 4943(f)(3)(A).
19 Reg. §1.509(a)-4(i)(4)(ii)(C).
20 Reg. §1.509(a)-4(i)(4)(ii)(B).
21 Reg. §1.509(a)-4(i)(5)(i)(A) and Reg. §1.509(a)-4(i)(5)(ii).
22 Reg. §1.509(a)-4(i)(5)(i)(A) and Reg. §1.509(a)-4(i)(5)(iii).
23 Temporary Reg. §1.509(a)-4T(i)(5)(ii)(B) and (C). The distributable amount for the first tax year an organization is treated as a nonfunctionally integrated Type III SO is zero.
24 Temporary Reg. §1.509(a)-4T(i)(8). There is a "reasonable cause exception" under Reg. §1.509(a)-4(i)(5)(ii)(F) which, if met, will not result in loss of Type III SO status where the organization fails to meet the minimum distribution requirement in a given tax year.
25 Reg. §1.509(a)-4(i)(7).
26 Reg. §1.509(a)-4(i)(6).
27 Reg. §53.4942(a)-2(c).
28 Reg. §1.509(a)-4T(i)(8).
29 Similar to private foundations, the reasonable and necessary administrative expenses of the Type III SO itself should count towards a distribution requirement. *See* Code Sec. 4942(g)(1)(A) (treating reasonable and necessary administrative expenses of a private foundation as qualifying distributions that are applied against a private foundation's five-percent annual distribution requirement under Code Sec. 4942).
30 Reg. §1.509(a)-4(i)(5)(iii)(A).
31 Reg. §1.509(a)-4(i)(5)(iii)(B)(1), (2) and (3).
32 Code Sec. 509(a)(3)(C). Under this requirement, the founder of a Type III SO, and his or her relatives, cannot be in a control position, unlike in the case of a private foundation.
33 Reg. §1.509(a)-4(j)(2).
34 A principal officer includes, but is not limited to, a person who, regardless of title, has ultimate responsibility for implementing the decisions of the governing body of a supported organization; supervising the management administration, or operation of the supported organization; or managing the finances of a supported organization. Reg. §1.509(a)-4(i)(2)(iv).
35 Reg. §1.509(a)-4(i)(2)(i)(A), (B) and (C).
36 Reg. §1.509(a)-4(i)(2)(iii).
37 Code Sec. 4958(a) and (c)(1)(A).

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