

IRS Releases Notice 2006-109 Interim Guidance Established for the Pension Protection Act of 2006

On December 4, 2006, the IRS released Notice 2006-109, which provides interim guidance on provisions of the Pension Protection Act of 2006 (the "Act") that affect donor-advised funds and supporting organizations. Both the Act and Notice 2006-109 impact educational institutions that have donor-advised scholarship funds and affiliated supporting organizations.

Prior to the enactment of the Act, there was no definition of a donor-advised fund in the Internal Revenue Code of 1986, as amended (the "Code"), or the Treasury Regulations. Generally, a donor-advised fund is a fund created within a public charity whereby the donor (individual or organization) is permitted to make recommendations as to the charitable expenditures from the fund. The donor-advised fund concept has historically been a community foundation concept, but through the years, donor-advised funds have become popular with many types of public charities, including colleges and universities.

Pursuant to the Act, the Code now defines donor-advised funds and imposes a 20% excise tax on taxable distributions that are made from these funds. Generally, a scholarship that is awarded by a donor-advised fund to a natural person is a taxable distribution (and therefore subject to a 20% excise tax) unless:

- The sponsoring organization appoints all the members of the awards committee and the donor's advice is given solely as a member of the committee
- The donor or any person appointed by the donor (or any related parties) do not directly or indirectly control the awards committee
- The grant is awarded on an objective and non-discriminatory basis using procedures that have been approved in advance by the board of directors of the sponsoring organization, and the procedures are designed to ensure that all grants meet the requirements of Code Sections 4945(g)(1), (2) and (3)

If the aforementioned requirements are not met, the sponsoring organization will be subject to a 20% excise tax.

Notice 2006-109 reflects the IRS' understanding that certain educational grants may have been committed to an individual on or before the date the Act was enacted, which would preclude the donor-advised fund from being able to satisfy the aforementioned requirements. Notice 2006-109 was issued to resolve this potential problem.

Notice 2006-109 provides that an educational grant made after August 17, 2006, shall not be treated as a taxable distribution if the grant is made pursuant to a grant commitment that was entered into on or before August 17, 2006. Notice 2006-109 also discusses under what circumstances a commitment will be considered entered into on or before August 17, 2006.

In addition to clarifying whether a donor-advised fund can fulfill its existing scholarship grant commitments without incurring a 20% excise tax, Notice 2006-109 also provides guidance to private foundations that desire to make grants to certain supporting organizations. The Act substantially impacts the ability of certain supporting organizations to receive gifts from private foundations.

Prior to the enactment of the Act, a private foundation was able to make a grant to any type of supporting organization (Type I, II or III) without having to exercise expenditure responsibility and such grants constituted qualifying distributions. Under the new law, a private foundation now must exercise taxable expenditure responsibility if it makes a grant to a "non-functionally integrated" Type III supporting organization or a Type I, Type II or "functionally integrated" Type III supporting organization if one or more disqualified persons of the donor private foundation directly or indirectly control the supporting organization. In addition, a grant to any such entity no longer qualifies as a qualifying distribution. As a result of these changes, private foundations will rarely, if ever, makes grants to "non-functionally integrated" Type III supporting organizations or controlled supporting organizations. These provisions of the Act required further guidance, however, because private foundations likely would be unable to confirm with any certainty whether a potential donee supporting organization is a Type I supporting organization, a Type II supporting organization, a "functionally integrated" Type III supporting organization or a "non-

functionally integrated” Type III supporting organization. Neither IRS determination letters nor IRS Publication 78 provides this information.

Notice 2006-109 was issued to provide safe harbors for private foundations that desire to make grants to supporting organizations. Notice 2006-109 provides that a private foundation grantor, acting in good faith, may rely upon a written representation signed by an officer, director or trustee of a grantee supporting organization that the grantee is a Type I supporting organization, Type II supporting organization or a “functionally integrated” Type III supporting organization, as long as the written representation contains certain specified information, the grantor private foundation reviews certain documents and the grantor private foundation verifies that the grantee is listed in IRS Publication 78 or obtains a copy of the grantee’s current IRS determination letter recognizing that the grantee is exempt from federal income tax. Alternatively, a grantor private foundation may rely on a reasoned written opinion from the grantor’s or grantee’s counsel concluding that the grantee is a Type I, II or “functionally integrated” Type III supporting organization.

If you have any questions regarding the Act or Notice 2006-109 or if you would like a copy of Notice 2006-109, please contact Rich Caputo, Esq., at rsc@stevenslee.com or 610-478-2155.

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