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## *BY HAND DELIVERY*

Commissioner of Internal Revenue  
Attn: CC:PA:LPD:PR (Notice 2007-21)  
Room 5203  
Internal Revenue Service  
Courier's Desk  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

### **RE: IRS Notice 2007-21, Study on Donor-Advised Funds and Supporting Organizations**

Dear Commissioner Everson:

On behalf of the American Hospital Association ("AHA"), we are submitting these comments in response to Notice 2007-21, Study on Donor Advised Funds and Supporting Organizations, published on February 26, 2007. You have asked for comments that would assist Treasury and the Internal Revenue Service ("IRS") in performing a study on the organization and operation of donor advised funds and of supporting organizations as required by section 1226 of the Pension Protection Act of 2006 ("PPA").

While you have raised important questions about requirements that define the framework for the organization and operation of supporting organizations, those questions are focused on supporting organizations whose purpose is grant-making and whose assets are contributed by a donor who is receiving charitable

contribution deductions for assets transferred. By contrast, the supporting organization structure is also utilized by public charities like hospitals whereby the supporting organization itself conducts substantial operating activities on behalf of its supported charities. The questions that you have raised are not relevant to this type of activities-based, “functionally integrated” supporting organization. Furthermore, there have been no abuses cited with respect to functionally integrated supporting organizations.

For this reason as set forth below, functionally integrated Type III supporting organizations that are supporting charitable hospitals should be defined as “functionally integrated” per se. Furthermore, functionally integrated supporting organizations should not be subject to a pay-out requirement under the forthcoming Treasury regulations, as such a requirement would deplete the resources necessary for such supporting organizations to conduct active operations on behalf of their supported public charities.

### **Background**

Supporting organizations were established by the Tax Reform Act of 1969 (“Tax Reform Act”). This legislation was aimed at curbing abuses associated with tax-exempt, charitable private foundations. Such abuses included self-dealing transactions between foundations and those who controlled them, failure to distribute any meaningful foundation income to charitable grantees, and excessive foundation involvement in business activities. Congress found that private foundations were more susceptible to donor abuse than public charities because donors were able to retain control over foundations in ways they could not retain control over public charities. To combat these abuses, the Tax Reform Act subjected private foundations to strict scrutiny and control through various restrictions, limitations, and excise taxes. Public charities were exempt from private foundation treatment on the theory that public scrutiny arising from an organization’s dependence on public funds would prevent abusive actions by such organizations. At the same time, Congress recognized the need for, and created the category of public charity known as “the supporting organization”, which was distinguished from private foundations because of its required relationship with its supported public charity. The supported public charity’s scrutiny over and control or involvement with the supporting organization would render unlikely the potential for donor manipulation and abuse present in private foundations.

In recent years, the supporting organization classification has been subject to misuse, including outrageous instances of purported charitable contributions to supporting organizations (most often on the advice of tax-avoidance promoters) with an immediate return of control of the donated assets to the donor often accompanied by favorable loans to the donor and other transactions. In these situations, the donors secured heightened tax benefits but retained almost unfettered control of the assets in the supporting organization. These abusive situations have been addressed in the PPA.

In contrast to the identified abusive situations, many supporting organizations serve public charities by providing for the efficient management of activities and assets, segregation of functions, and asset protection. These activities-based supporting organizations are providing a substantial benefit to the public charities they support and the charitable sector in general. It is therefore necessary to understand and differentiate between abusive uses for supporting organizations and the critical role that activities-based, functionally integrated supporting organizations play in furthering the charitable purposes of their supported organizations.

### **Hospitals and Supporting Organizations**

In considering the expected effects of the PPA provisions applicable to supporting organizations, we urge Treasury and the IRS to be mindful of the critical importance of the Type III supporting organization structure to nonprofit hospital systems.

Nonprofit hospital systems often have a Type III supporting organization serving as the parent entity in a system of multiple charitable hospitals. The parent supporting organization engages in important system-wide activities on behalf of its supported charitable hospitals, clinics, and related charitable entities to promote health care. For example, the parent supporting organization often undertakes quality care initiatives that are implemented system-wide, designs and implements system-wide information technology programs, negotiates on behalf of the system to purchase supplies in bulk, and undertakes other activities to streamline and enhance the delivery of charitable health services by the hospitals in the system. Thus, hospital system parent supporting organizations actively carry on activities to assist the charitable entities in their system in promoting charitable health care purposes.

To address abuses in which donors have received large charitable tax deductions for gifts to grant-making Type III supporting organizations of assets that produce little income that can be given to charities as grants, the PPA adopts a series of changes to the Federal tax rules governing Type III supporting organizations, including directing Treasury to promulgate new regulations formally defining a “functionally integrated” supporting organization and imposing a mandatory pay-out requirement on supporting organizations that are not functionally integrated. (See chart summary of PPA provisions at Attachment A).

As noted above, rather than making grants to others, hospital system parent supporting organizations *actively carry on activities* to assist the supported charities in their system in promoting charitable health care purposes. Accordingly, these nonprofit hospital systems, which have relied upon current law “functionally integrated” rules in the existing regulations and IRS rulings, should be able to continue such reliance, to provide the necessary certainty for their charitable status. They should not have to risk entanglement in new rules directed at abuses committed by others.

In developing regulations to define “functionally integrated Type III supporting organizations” the IRS should look to the analysis and approach of its existing guidance. The term “functionally integrated”, which is not defined in the Code or existing regulations, has evolved as a description of the “activities” test for the “integral part” test for a Type III. Reg. 1.509(a)-(4)(i)(3)(i) and (ii) states as follows:

(3) *Integral part test; general rule.*—(i) For purposes of this paragraph, a supporting organization will be considered to meet the “integral part test” if it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii) The activities engaged in for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves.

In an extensive body of private letter rulings, the Service already has undertaken considerable analysis and drawn sensible distinctions as to the types of activities that will – and will not – satisfy the “functionally integrated” organization test for Type III supporting organization status, particularly in the hospital context. These rulings have considered the situation of activities-based supporting organizations of tax-exempt hospital systems and have properly concluded that the “functionally integrated” test for Type III status has been met. For example, the Service has ruled that “qualifying activities” include overall coordination and supervision of a hospital system, including approving the budgets, strategic planning, marketing, resource allocation, endowment management and managing community education programs. (See a summary chart of the existing rulings addressing “qualifying” and “non-qualifying” activities at Attachment B.)

We strongly urge that, in developing regulations to define “functionally integrated” Type III supporting organizations, the Service should look to the analysis that it already has undertaken and the approach that it already has developed in existing letter ruling guidance to hospital systems. These are fair and sensible distinctions that accomplish the policy objectives of the supporting organizations, while curbing the potential for abuse.

As Treasury and IRS are performing a study generally considering the organization and operation of supporting organizations, we urge you to consider that parent supporting organizations of charitable hospital systems, based on the nature and extent of the activities they undertake in support of their charitable hospitals and related entities, should be considered per se functionally integrated Type III supporting organizations. In the alternative, examples could be added to the existing regulations that could be used to issue guidance before proposed regulations are promulgated. Set forth below are examples drawn directly from the rulings summarized in the attached chart that would clarify the definition of “functionally integrated” Type III supporting organizations.

Section 1.509(a)-4(i)(3)(ii). *This subdivision may be illustrated by the following examples:*

*Example (1). X, an organization described in section 501(c)(3), is the parent corporation of an integrated educational and health care system. X is responsible for coordinating the policy-making and long-range planning for the system, providing essential support services, and formulating relationships within the system. Support services include food services,*

*maintenance, transportation, laundry, typing pool, accounting, data processing, payroll, purchasing, personnel, security, and general administration. X meets the responsiveness test described in subparagraph (2) of this paragraph. Under these circumstances, X will be treated as performing functions of the related exempt organizations which, but for the involvement of X, would normally be performed by such organizations themselves.*

*Example (2). X, an organization described in section 501(c)(3), is the parent of an integrated hospital system. X manages and supervises the activities of its exempt subsidiary organizations and coordinates policy-making and long-range planning to meet patient needs. X also provides services to non-exempt entities which do not account for a substantial portion of its total income. X meets the responsiveness test described in subparagraph (2) of this paragraph. Under these circumstances, X will be treated as performing functions of the exempt subsidiary organizations which, but for the involvement of X, would normally be performed by such organizations themselves, even though X is performing similar services to nonexempt entities.*

*Example (3). X, an organization described in section 501(c)(3), is the parent of a healthcare system. X engages in the overall coordination and supervision of the system's exempt subsidiary corporations in approval of budgets, strategic planning, marketing, resource allocation, endowment management, securing tax-exempt bond financing, and community education. X meets the responsiveness test described in subparagraph (2) of this paragraph. Under these circumstances, X will be treated as performing functions of the exempt subsidiary organizations which, but for the involvement of X, would normally be undertaken by such organizations themselves.*

Finally, to avoid disrupting the active operations of these activities-based organizations, such functionally integrated supporting organizations should not be subject to a pay-out requirement under the forthcoming Treasury regulations. Such a requirement would deplete the resources necessary for such supporting organizations to conduct active operations on behalf of their supported charities.

We and representatives from AHA would be pleased to meet with the Service to discuss these comments in greater detail and to offer any technical assistance that

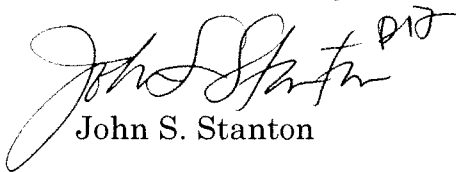
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might be helpful to the Service as it prepares its study and develops future guidance relating to supporting organizations.

Sincerely,



Deborah T. Ashford

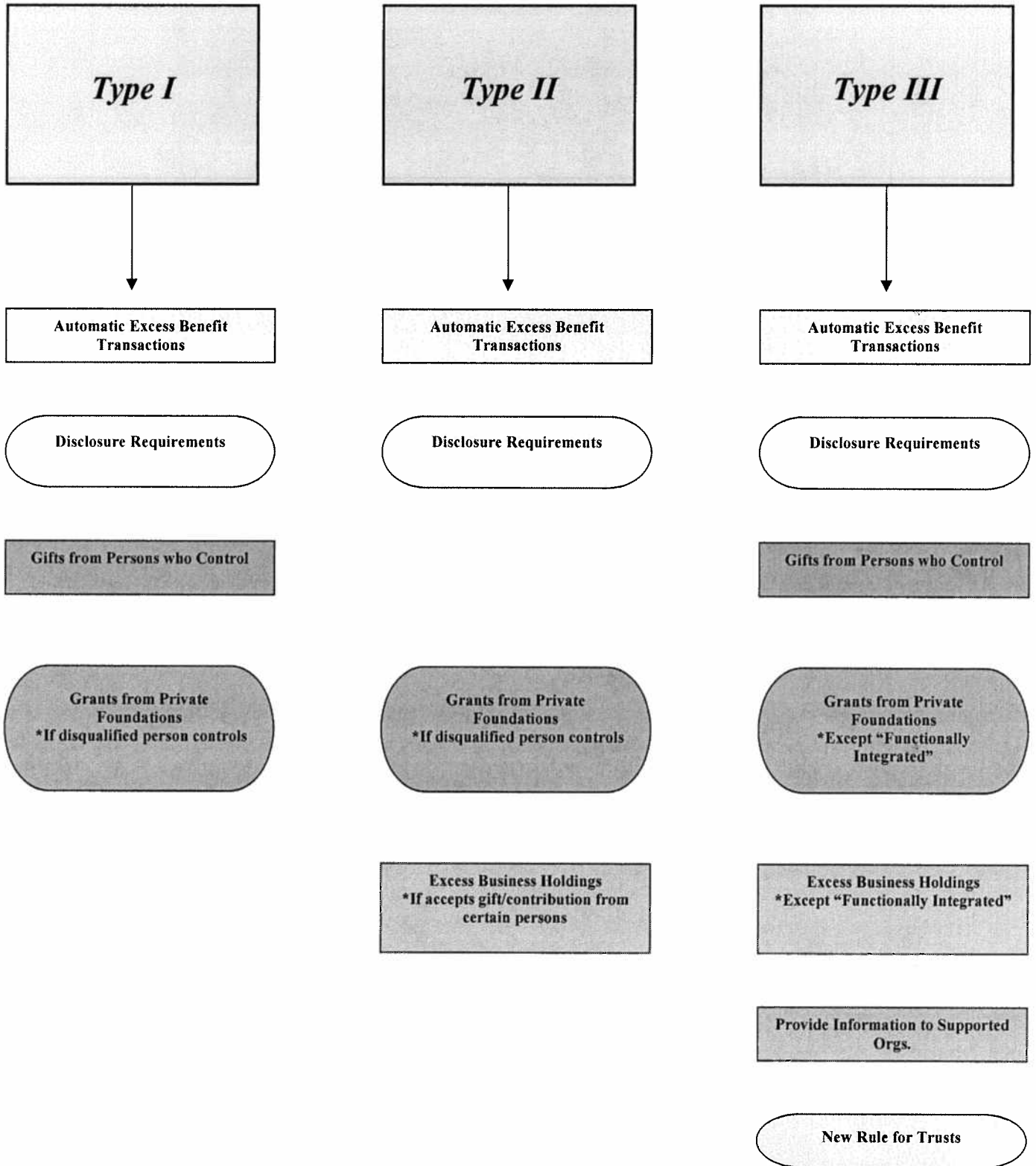


John S. Stanton

Attachments

ATTACHMENT A

Summary of Pension Protection Act of 2006 Changes to Supporting Organizations





**ATTACHMENT B**

**“QUALIFYING” ACTIVITIES UNDER THE “FUNCTIONALLY INTEGRATED TEST” 1/**

SOURCE	DESCRIPTION OF ACTIVITIES	RELEVANT LANGUAGE
PLR 8934030 (Hospital system)	<ul style="list-style-type: none"> <li>▪ Coordinating the policymaking and long range planning for a hospital system</li> <li>▪ Providing essential support services for its subsidiaries, including:                             <ul style="list-style-type: none"> <li>▫ food services</li> <li>▫ maintenance</li> <li>▫ transportation</li> <li>▫ laundry</li> <li>▫ typing pool</li> <li>▫ accounting</li> <li>▫ data processing</li> <li>▫ payroll</li> <li>▫ purchasing</li> <li>▫ personnel</li> <li>▫ security</li> <li>▫ general administration.</li> </ul> </li> <li>▪ Formulating relationships within the hospital system.</li> </ul>	Because supporting organization can be considered an integral part of the integrated educational and health care system and because it is performing functions which the supported organization could perform itself, the reorganization will not adversely affect the exempt status of the supporting organization.
PLR 9016053 (Hospital system)	<ul style="list-style-type: none"> <li>▪ Manage and supervise activities of the exempt subsidiary entities</li> <li>▪ Coordinate public policy-making and long range planning to meet patient needs</li> <li>▪ Perform home office administrative, management, development</li> <li>▪ Planning and management support functions</li> </ul>	The management and administrative activities being performed by the supporting organization for the benefit of subsidiaries are the type of activities the subsidiaries would continue to perform for themselves but for the existence of the supporting org. The supporting organization also received 5% of its income from the provision of similar services to nonexempt entities.

1/ This chart summarizes our review of the rulings and cases in which the Service has considered the definition of “functionally integrated Type III’s”.

<p>PLR 9347031; 9347032; (Hospital Systems)</p>	<ul style="list-style-type: none"> <li>▪ Planning; coordination; and eliminating duplications</li> </ul>	<p>The management and administrative activities that will be performed by the supporting organization for the benefit of its affiliated organizations are the type of activities that the affiliated organizations would continue to perform for themselves but for the supporting organizations existence, "as required to meet the integral part test under section 1.509(a)-4(i)(3)(ii)."</p>
<p>PLR 9714004 (Retirement Facility)</p>	<ul style="list-style-type: none"> <li>▪ Planning and developing additional facilities and services for the aged.</li> </ul>	<p>But for the involvement of the supporting organization; the supported organizations would normally be engaged in the listed activities on their own behalf.</p>
<p>PLR 9725035 (Healthcare related organization)</p>	<ul style="list-style-type: none"> <li>▪ Provide funding for health care for indigent individuals</li> <li>▪ Provide funding for the operation and maintenance of needed health care facilities</li> <li>▪ Plan for the unmet needs of the community</li> <li>▪ Provide services and financial assistance to organizations for purposes related to the provision of health</li> </ul>	<p>Supporting organization meets the requirements of section 1.509(a)-4(i)(3) of the regulations regarding the integral part test.</p>
<p>PLR 200033050 (Continuing care retirement community)</p>	<ul style="list-style-type: none"> <li>▪ Manage facilities of subsidiaries</li> <li>▪ Assist with and perform planning, financial, legal, management quality improvement and other functions for subsidiaries.</li> </ul>	<p>But for the involvement of the supporting organization; the supported organizations would normally be engaged in the listed activities on their own behalf.</p>
<p>PLR 9517051 (Hospital system)</p>	<ul style="list-style-type: none"> <li>▪ Overall coordination and supervision of the system's three exempt subsidiary corporations in approval of budgets, strategic planning, marketing, resource allocation, endowment management and community education</li> </ul>	<p>Because both supporting organization's operations are activities and functions that would otherwise have to be performed by the publicly supported organizations "but for" the fact that the supporting organizations perform such activities and functions.</p>

	<ul style="list-style-type: none"> <li>Second supporting organization in hospital system is a fundraising foundation that obtains contributions from the public and is also engaged in public education activities</li> </ul>	
PLR 9837037  (Hospital system)	<ul style="list-style-type: none"> <li>Provide strategic oversight and advice</li> <li>Second supporting organization provides financial assistance to and sponsors specific projects and programs in connection with the purposes and objectives of the hospital operating division it supports</li> </ul>	<p>This strategic direction and advice is a function that normally would be engaged in by the supported organization itself and therefore the supporting organization will satisfy the integral part test. Same analysis for second supporting organization.</p>
PLR 200404057  (Nursing homes)	<ul style="list-style-type: none"> <li>Lease a nursing home facility</li> </ul>	<p>Lease arrangement established to pursue debt financing and other balance sheet considerations. The Service ruled that leasing the facility to a supported organization was an activity that satisfied the “functionally integrated” prong.</p>
PLR 8536001  (Grant-making on behalf of public school system)	<ul style="list-style-type: none"> <li>Income from trust used to aid temporarily incapacitated teachers in the public schools of a city who, by reason of health, needed rest and recuperation in order to properly resume their teaching duties</li> <li>Purely grant-making activities based on need; in some years no requests for aid are received and therefore no grants paid</li> </ul>	<p>The Service did not believe that it was “normal”, in the sense of usual, for a school system to provide the sort of aid provided by this trust. However, the aid already having been provided for over 70 years, the Service reasoned that it was highly unlikely that the cessation of the benefit would go unchallenged. The Service had no reason to doubt the assertion made by the president of the teachers union that the union would attempt to restore this benefit even though other activities of the Board of Education might have to be curtailed to supply it, regardless of how successful such an attempt might be. The Service found it sufficient in the circumstances that a similar, or substitute benefit, would have to be seriously considered if the trust were to cease</p>

		operation and therefore found the integral part test satisfied.
PLR 9333046 (Hospital System)	<ul style="list-style-type: none"> <li>▪ First supporting organization will provide financial, management and advisory support services. Specifically, it will provide: <ul style="list-style-type: none"> <li>▪ legal services</li> <li>▪ strategic planning services</li> <li>▪ employee benefits; group insurance and retirement plans</li> <li>▪ monitor financial obligations and banking relationships</li> <li>▪ provide oversight of investment portfolios handled by investment advisors</li> </ul> </li> <li>▪ develop operational financial statements</li> <li>▪ In the future the supporting organization may: <ul style="list-style-type: none"> <li>▪ coordinate data processing systems development</li> <li>▪ fund development</li> <li>▪ advise on construction or modification of building systems and equipment</li> <li>▪ project cost estimating and management, safety, security, fire protections and disaster planning</li> <li>▪ personnel support services</li> <li>▪ marketing services</li> </ul> </li> <li>▪ The second supporting organization B engages in raising, managing and investing funds for the benefit of the hospital</li> </ul>	<ul style="list-style-type: none"> <li>▪ The management and administrative activities to be performed by the supporting organization for the benefit of two supported organizations are the types of activities that the supported organizations would continue to perform themselves but for the existence of the supporting organization.</li> <li>▪ After the reorganization, supporting organization B will continue to engage in raising, managing and investing funds, activities which, but for the existence of B, would be conducted by the hospital as an integral part of its activities.</li> </ul>
PLR 9139025 (Hospital System)	<ul style="list-style-type: none"> <li>▪ Supporting organization M, the parent entity, will provide financial management and advisory support services and own and manage the endowment assets</li> <li>▪ Supporting organization O operates an imaging center and performs mammography, magnetic resonance imaging and ultrasounds for patients of the hospital.</li> </ul>	M is considered an integral part of the integrated health system. M and O will be considered integral parts of N.
PLR 9109057 (Hospital System)	<ul style="list-style-type: none"> <li>▪ Supporting organization P, the parent entity, will provide overall planning and coordination for the health care system.</li> </ul>	Because P can be considered an integral part of the integrated health system within the meaning of Rev. Rul. 78-41, supra, and because it is performing functions which A

		and B could otherwise perform themselves, the reorganization will not adversely affect the exempt status of P.
PLR 9013049 (Hospital System)	<ul style="list-style-type: none"> <li>▪ Provide management, administrative and fundraising activities for the hospital system</li> </ul>	The activities are the type that the hospital did and would continue to perform for itself but for the existence of the supporting organization.
PLR 8907060 (Hospital System)	<ul style="list-style-type: none"> <li>▪ Provide overall planning and coordination</li> <li>▪ Operate the related educational programs</li> <li>▪ Conduct fundraising activities for the system</li> <li>▪ Provide certain health care services other than hospital services</li> </ul>	The activities are of the type that the supported organization did and would continue to perform for itself but for the existence of the supporting organization.

**“NON-QUALIFYING” ACTIVITIES UNDER THE “FUNCTIONALLY INTEGRATED TEST”**

SOURCE	DESCRIPTION OF ACTIVITIES	RELEVANT LANGUAGE
<p>1982, 1997, 2001 and 2004 EO CPE Texts; GCM 36523; GCM 36379, and GCM 36043; Exemption Ruling, Shanshoian Family Foundation, 2006 WL 2587647</p>	<p>Only making grants to support publicly supported organizations</p>	<p>The Service indicates in all of these documents, that only making grants to publicly supported organizations will not satisfy the integral part test in section 1.509(a)-4(i)(3)(ii).</p>
<p><i>Lapham Foundation, Inc. v. Comm'r of IRS</i>, 389 F.3d 606</p>	<p>Contributing money to a supported organization or making grants to charities by giving money to a supported organization.</p>	<p>“To begin with, it is unclear that the Foundation is engaging in any activity “for or on behalf” of AEF, given that its only activity is contributing money to AEF. Even if donating money to AEF was considered an activity “for” AEF, it is not an activity AEF itself would be doing but for the Foundation.”</p>
<p>TAM 9730002</p>	<p>Organization supports the activities of a City Science Center by investing funds and granting funds to the City.</p>	<p>Even though such activity may benefit the City, the Service reasoned the activities do not meet the “but for” test because the organization is not</p>

		performing the City's functions or carrying out its purposes.
<i>Cuddeback v. Comm'r IRS</i> , T.C. Memo 2002-300	Only distributing funds to a supported organization.	“Petitioner does not engage in activities on behalf of Keswick, other than distributing funds to Keswick, and, thus, does not claim to satisfy the first method of complying with the integral part test, as described in section 1.509(a)-4(i)(3)(ii)”