



COUNCIL *on* FOUNDATIONS

LEGAL COMPENDIUM FOR COMMUNITY FOUNDATIONS

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CHAPTER 4, Rules Governing Non-Component Funds

This is an excerpt from the *Legal Compendium for Community Foundations* (Council on Foundations, 1996).

Note that while much of the information in the following excerpt is still accurate and relevant, some changes in the law and regulations may affect portions of this material. For this reason, this material should be read in conjunction with other, more recent resources, or should be used in consultation with local counsel who can advise on any changes.

CHAPTER FOUR: RULES GOVERNING NON-COMPONENT FUNDS

A. General Rule: Non-Component Fund Is a Separate Organization

B. Special Rules for Split Interest Trusts (Charitable Remainder Trusts, Pooled Income Funds, etc.)

C. Special Rules for Donor-Directed Funds

1. Overview

2. Donor-Directed Fund Permitted by State a. Overview

b. Technical Rules

c. Controversy over Public Charity Status

3. New Forms of Donor-Directed Funds

Chapter Four

Rules Governing Non-Component Funds

A. General Rule: Non-Component Fund Is a Separate organization

A non-component fund is a trust, corporation or association administered by a community foundation that does not satisfy the single-entity regulations, usually because it is subject to a material restriction.³⁸⁴ It will be treated for tax purposes as a separate entity that is obligated to file its own tax return³⁸⁵ It will usually be a private foundation³⁸⁶ (with special rules for some trusts)³⁸⁷ unless it can be classified as a public charity in its own right.³⁸⁸

Several community foundations have found it advantageous to establish non-component funds (most notably supporting organizations, charitable remainder trusts, pooled income funds and donor-directed funds) because they attract resources to, and donor involvement with, the community foundation. Provided that the organizational documents (articles of incorporation or trust instrument) and bylaws of a community foundation permit non-component funds, the decision as to whether or not a community foundation will administer a non-component fund is up to the governing body. As long as all parties understand the consequences of accepting contributions subject to a material restriction, then all parties can agree to whatever reasonable terms are appropriate.

A donor's contribution to a non-component fund will generally be treated as a contribution to a private foundation instead of a public charity, although there are several important exceptions. First, a contribution to a supporting organization of a community foundation will qualify as a gift to a public charity.³⁸⁹ Second, the non-component fund might be a public charity if it can pass

³⁸⁴ Treas. Reg. Sections 1.170A-9 (e) (14) (i) and 1.170A-9(e) (11) (ii).

³⁸⁵ *Id.* These entities are defined in Treas. Reg. Section 301.7701-4 (trusts), I.R.C. Section 7701 (a) (3) (corporations) and Treas. Reg. Section 301.7701-2 (associations). Note that a directly owned philanthropic fund of an incorporated community foundation is probably not capable of being a separate entity that would have to file a separate tax return. It does not meet the definition of a trust, corporation or association. It is only an accounting entry on the books of the community foundation.

³⁸⁶ *Id.* Under Section 509(a), every charity is presumed to be a private foundation unless it qualifies for a public charity exception.

³⁸⁷ Some trusts might be subject to the rules of Section 4947. Section 4947 imposes on certain charitable trusts the same income and excise taxes that are imposed on private foundations, even though they do not meet all of the technical requirements to be a private foundation. It also addresses the tax treatment of some split-interest trusts (trusts that benefit both a charitable organization and a non-charitable purpose, such as charitable remainder trusts and pooled income funds).

³⁸⁸ Treas. Reg. Section 1.170A-9 (e) (14) (i). It may be possible for the fund to be classified as a public charity if it can pass the public support test or if it can be classified as a supporting organization. See the following two footnotes.

³⁸⁹ A supporting organization is a type of public charity that does not have to pass the public support test. Section 509 (a) (3). See, generally, Chapter EIGHT for the rules governing supporting organizations of community foundations. A supporting organization generally will not qualify as a component fund because it has an independent governing body that makes its own grant decisions.

the public support test.³⁹⁰ Third, a contribution to a properly structured "donor-directed fund" (described below) will still qualify for the same generous tax treatment as a contribution to a public charity even if the fund is classified as a private foundation³⁹¹ Fourth, the deductible portion of a contribution to a deferred giving arrangement that is for the benefit of a public charity, such as a charitable remainder trust or a pooled income fund, will also qualify for the same tax treatment as a contribution directly to a public charity.³⁹²

What should be avoided at all costs is IRS reclassification of a component fund as a non-component fund because of a subsequent determination that the fund was subject to a material restriction. A community foundation could suffer a serious blow to its prestige if such a reclassification should take place, especially after it had made representations to the community and to the IRS that the fund was a component fund; that charitable contributions to it qualified for the most advantageous tax treatment; and that it was exempt from all private foundation excise taxes.³⁹³

In the event of the reclassification of a fund as a non-component fund, the tax regulations excuse the failure of the trust or corporation to file tax returns if the community foundation had previously classified it as a component fund.³⁹⁴ Thereafter the entity will be responsible for filing its own returns. A reclassification will not cause the entire community foundation to fail the single-entity requirements.³⁹⁵

Usually a donor will make a conscious decision whether the trust or corporation is intended to be a supporting organization or a component fund. However, there may be situations where a donor had hoped to have a component fund but it fails to qualify because the donor imposed a material restriction. If the fund is a designated fund, it may be possible to have it classified as a supporting organization of either the community foundation or of the other public charity that it was established to benefit. The outcome depends on whether the entity meets the organizational and operational tests of Section 509(a) (3). See, however, *Quarrie Charitable Fund v. Commissioner*, 603 F.2d 1274 (7th Cir. 1979) in which the court held that a trust that was required to pay income to three public charities (one was a community foundation) was not a supporting organization because the trustee had the power to substitute other public charities if the trustee concluded that continued payments were undesirable or impractical. The case is analyzed in Section THREE.C.8 of this publication.

³⁹⁰ This could be the case if enough unrelated donors contribute to it. See Section TWO.D of this publication for the mechanics of the public support test.

³⁹¹ Sections 170(b) (1) (A) (vii) and 170(b) (1) (E) (iii). See Section FOURC for a description of such funds.

³⁹² Treas. Reg. Section 1.170A-8 (a) (2). Of course, this rule only applies to the portion of the gift that qualifies for a charitable deduction. For example, assume that a donor contributes \$100,000 to a charitable remainder trust that will pay income to her for life and will distribute the assets to a community foundation at her death. If the applicable charitable deduction is \$40,000, then the donor can claim an income tax deduction for a \$40,000 gift to a public charity. This is the case even though the charitable remainder trust is subject to some of the private foundation excise taxes. See, generally, Section NINE.C for the rules governing gifts to deferred charitable giving arrangements.

³⁹³ The only published situation where the IRS was prepared to reclassify a fund as a non-component fund was where sizeable grants were about to be made from two advised funds to donor-directed funds (they are treated as private foundations under Section 170 (b) (1) (E) (iii)). Private Letter Ruling 8134046 (May 26,1981).

³⁹⁴ Treas. Reg. Section 1.170A-9 (e) (14) (i). Trusts and corporations that are component funds do not have to file separate income tax returns since their financial transactions are included as part of the community foundation's tax return. Private Letter Ruling 8621112 (Feb. 28,1986).

³⁹⁵ See GCM 33818 (Jan. 11, 1979) at footnote 3.

Finally, it may be possible to have a non-component fund converted to a component fund by having the material restriction removed. This result is implied in a tax regulation and a general counsel memorandum.³⁹⁶ In other words, the imposition of a material restriction does not mean that the fund will be permanently classified as a non-component fund since the status of the fund can be changed by the removal of the restriction. All of the other restrictions that are not material can remain in place. If the fund had been classified as a private foundation, it may have to meet the private foundation termination rules described in Section SEVEN.D, but in most cases that will not be a problem. In many states it is possible to amend the organizational document of the fund (e.g., trust instrument or articles of incorporation) to remove the material restriction. The non-component fund could then terminate its private foundation status by becoming either a component fund or a supporting organization of the community foundation.³⁹⁷

B. Special Rules for Split-Interest Trusts (Charitable Remainder Trusts, Pooled Income Funds, etc.)

The most common form of split interest arrangements is deferred charitable gifts, such as charitable remainder trusts and pooled income funds. Under these arrangements, the trust pays income to the donor or some other specified individual over a period of time (usually his/her lifetimes) and, upon his/her death, the principal is severed from the trust and distributed to the community foundation.³⁹⁸ A charitable lead trust is the inverse: income is distributed to a charity and the remainder interest passes to non-charitable beneficiaries, typically the children of the donor.³⁹⁹ Deferred giving vehicles are analyzed in Chapter NINE.

Many community foundations act as trustees, or appoint trustees, of pooled income funds that they have established. Many also serve as trustees, or appoint trustees, of

³⁹⁶ Treas. Reg. Section 1.170A-9(e) (14) (ii) provides that a charitable remainder trust is a non-component fund because income is distributed to a non-charitable beneficiary (usually the donor), but that upon the death of the donor it "will be treated as a component part of the community trust" if at that time the terms of the trust meet the single-entity requirements. See Sections FOUR.B and Chapter NINE.A.3 of this publication for rules regarding split interest trusts. The IRS also concluded that distributions of investment income from a decedent's trust to a community foundation would be treated as contributions but that after the noncharitable beneficiaries died and the community foundation became the sole beneficiary, then the trust would become a component fund and the investment income of the trust would be treated as investment income of the community foundation. GCM 38880 Qlty 21, 1982).

³⁹⁷ The Seventh Circuit Court of Appeals suggested this strategy to convert an Illinois private foundation into a supporting organization of several public charities, including a community foundation. *Quarrie Charitable Fund v. Commissioner*, 603 F.2d 1274, at 1280 (7th Cir. 1979). See Section THREE.A.2. for the requirements of a component fund and Chapter EIGHT for analysis of supporting organizations.

³⁹⁸ Only certain split-interest arrangements qualify for advantageous tax treatment. Pooled income funds must meet the requirements of Section 642(c) (5) and the applicable regulations. Charitable remainder annuity trusts, charitable remainder unitrusts and charitable remainder lead trusts must meet the requirements of Section 664(d) and the applicable regulations.

³⁹⁹ Sections 2053(e) (2) (B) and 2322(c) (2) (B).

charitable remainder trusts that donors have established.⁴⁰⁰ The tax regulations state that such split interest trusts do not qualify as component funds.⁴⁰¹ The payment of income (or, in the case of a charitable lead trust, the payment of corpus) to individuals constitutes a material restriction that prevents the community foundation from having unfettered use of the trust's assets for its charitable purposes.⁴⁰² Consequently, the trust must prepare a separate tax return under the rules applicable to split interest charitable trusts and pooled income funds.⁴⁰³ See GCM 38880 for an analysis of how split interest trusts are treated as non-component funds and how distributions affect the public support test.⁴⁰⁴

Despite the lack of component fund status, split interest trusts can serve as a vehicle for establishing philanthropic funds at a community foundation. For example, upon the termination of a charitable remainder trust or upon the death of the income beneficiary of a pooled income fund account, the assets can be distributed to the community foundation to establish, or to add to, a philanthropic fund (unrestricted, field-of-interest, designated or advised).⁴⁰⁵ The IRS also issued a private letter ruling in which it authorized an advised fund to be established with income distributions from a charitable lead trust to a community foundation.⁴⁰⁶

As an alternative to distributing assets to a community foundation, a charitable remainder trust can retain the corpus and can itself become a component fund after all non-charitable interests expire, but only if the terms of its governing instrument satisfy the single entity requirements.⁴⁰⁷

By comparison, a charitable lead trust can never become a component fund.⁴⁰⁸

C. Special Rules for Donor-Directed Funds

1. OVERVIEW

A donor-directed fund permits a donor to annually designate the public charities that will receive the income from the donor's account in the fund. Because the donor has the right to designate the beneficiary, as opposed to the privilege to merely advise the community foundation, the fund is subject to a material restriction and is therefore a

⁴⁰⁰ The tax regulations specifically authorize publicly supported community foundations to have pooled income funds. Treas. Reg. Section 1.170A-9 (e) (14) (ii) (last sentence). Many of the legal requirements for acting as trustee are described in Section NINE.D.

⁴⁰¹ Treas. Reg. Section 1.170A-9(e) (14) (ii).

⁴⁰² *Id.*

⁴⁰³ *Id.* Charitable remainder trusts file Form 5227 and pooled income funds file Forms 3227 and 1041.

⁴⁰⁴ GCM 38880 (July 21, 1982).

⁴⁰⁵ Private Letter Ruling 8924040 (Mar. 20, 1989). See, however, Section NINE.G.3 and Rev. Rul. 92-108 (rescinded by Rev. Rul. 93-8) for a possible controversy about establishing a designated fund with a distribution from a pooled income fund.

⁴⁰⁶ Private Letter Ruling 8146072 (undated).

⁴⁰⁷ Treas. Reg. Section 1.170A-9(e) (14) (ii).

⁴⁰⁸ A charitable lead trust can never be a component fund since the charitable interest will expire before the non-charitable interest. GCM 38880 (July 21, 1982).

non-component fund.⁴⁰⁹ One type of donor-directed fund is specifically described in the tax statutes.⁴¹⁰ Other forms of donor-directed funds emerged in the early 1990s. A few community foundations have established donor-directed funds as separate corporations. These community foundations have found that the funds are an attractive option to donors who insist on maximum legal control. They also serve as a way to begin a relationship between a community foundation and a donor for further philanthropic cooperation in the community. Other community foundations have opted against offering such funds to their donors. There are many reasons, but perhaps the predominant reason is a belief that the existence of these funds may be a detriment to other types of philanthropic funds (unrestricted, field-of-interest, advised, etc.) that are of greater importance to the community foundation.

There are legal controversies as to whether a donor-directed fund can qualify as a public charity and whether some forms of donor-directed funds can qualify as charities at all. In the early 1990s, the IRS classified some donor-directed funds as private foundations and others as public charities. In 1995, the IRS launched an audit program of donor-directed funds and it issued a publication that was critical of allowing donor-directed funds to be classified as public charities.⁴¹¹ The IRS is clearly hostile to public charity status and a community foundation should proceed very cautiously if it attempts any innovative format beyond the use of donor-directed funds that is permitted by the statute.⁴¹²

2. DONOR-DIRECTED FUND PERMITTED BY STATUTE

a. Overview

Section 170(b) (1) (E) (iii) permits a donor-directed fund to give each donor the legal right to annually designate certain types of public charities as the beneficiaries of the donor's share of income from the fund. Only public charities described in Section 509 (a) (1) are eligible beneficiaries. Other public charities described in Section 509 (a) (2) (charities with considerable revenue from services, such as some symphonies) and Section 509 (a) (3) (supporting organizations) are not eligible grant recipients. Since a community foundation is itself a Section 509 (a) (1) organization,⁴¹³ the operating procedures of the donor-directed fund can specify that a certain portion of the income or principal will be distributed to the community foundation.

The statute describes this type of a pooled donor-directed fund as a private foundation, although there is an argument that it can qualify as a public charity (see below). If the donor-directed fund is a private foundation, then it is subject to all of the private

⁴⁰⁹ Treas. Reg. Sections 1.170A-9 (e) (14) (iii); 1.170-A9 (e) (11) (it); and 1.307-2 (a) (8) (iv) (A) (1).

⁴¹⁰ Section 170(b) (1) (E) (iii) describes a type of pooled donor-directed fund that is classified as a private foundation.

⁴¹¹ See *infra* n. 431 and the accompanying text.

⁴¹² See Section 170(b) (1) (E) (iii) and Rev. Rul. 80-305, 1980-2 C.B. 71, described *infra* at n. 422, for illustrations of permissible uses of donor-directed funds.

⁴¹³ Treas. Reg. Section 1.170A-9(e) (11) mentions the public support test under Section 170(b) (1) (a) (vi), which is governed by Section 509 (a) (1). See Chapter TWO for the public support test.

foundation excise taxes. One of the principal disadvantages of private foundation status is that the donor-directed fund will be liable for the 2% excise tax on capital gains generated from the sale of stock contributed by the donor, based on the donor's cost basis in the stock.⁴¹⁴ By comparison, a component fund and a public charity are not liable for that tax.

Despite its status as a private foundation, Congress determined that contributions to such a fund should qualify for the same advantageous tax treatment as contributions to a public charity.⁴¹⁵

b. Technical Rules

There are several technical requirements to establish a Section 170(5) (1) (E) (iii) donor-directed fund. The governing instrument must provide, and the organization must in fact comply with, the following requirements:⁴¹⁶

- (1) All of the contributions must be pooled in a common fund.
- (2) The organization would be a "supporting organization" under Section 509 (a) (3) but for the right of any substantial contributor⁴¹⁷ or spouse:
 - (a) to designate annually the Section 509 (a) (1) organizations that will receive the income attributable to his or her contribution to the fund⁴¹⁸ and
 - (b) to direct (by deed or by will) the payment to a Section 509 (a) (1) organization of the corpus attributable to the contribution.
- (3) All of the adjusted net income of the common fund must be distributed to one or more Section 509 (a) (1) organizations not later than the 15th day of the- third month after the close of the taxable year in which the income is realized by the fund.⁴¹⁹
- (4) All of the corpus attributable to any substantial contributor's contribution to the fund must be distributed to one or more Section 509 (a) (1) organizations not later than one

⁴¹⁴ For example, if a donor contributes stock that the donor purchased for \$10,000 ten years ago but is worth \$100,000 at the time of gift, and if the donor-directed fund sells the stock for \$120,000, then it will be liable for a tax of \$2,200 (2% times (\$120,000 minus \$10,000)) if it is classified as a private foundation. *Friedman Foundation v. Commissioner*, 71 T.C. 40 (1978), which interprets Treas. Reg. Section 53.4940-1 (f) (2) (i) (B).

⁴¹⁵ Section 170 (b) (1) (A) (vii).

⁴¹⁶ Treas. Reg. Sections 1.170A-9(e) (14) (iii); 1.170A-9 9(e) (11) (ii), and 1.507-2(a) (8) (iv) (A) (1).

⁴¹⁷ A substantial contributor is defined as someone who contributed more than 2% of the sum of the total contributions plus investment income of the foundation over a specified period of time. Section 507(d) (2) and Treas. Reg. Section 1.170A-9(h) (4) (i). Section 507 (d) (2) contains a series of special rules, including situations when a donor can cease to be a substantial contributor.

⁴¹⁸ Treas. Reg. Section 1.170A-9(h) (4) (iii) defines the term "income attributable to" to mean the income earned by the fund which is properly allocable to the contributed amount by any reasonable and consistently applied method. See, for example, Treas. Reg. Section 1.642(c)-5(c).

⁴¹⁹ The adjusted net income is determined by using the definition in Section 4942 (f). Treas. Reg. Section 1.170A-9(h) (2) (i).

year after his or her death or after the death of his or her surviving spouse if she or he has the right to designate the recipients of such corpus.⁴²⁰

An organization will not fail to qualify as a donor-directed fund merely because a substantial contributor or the spouse fails to exercise the right to designate the recipients of income or corpus of the fund if the organization takes steps to see that the income and corpus attributable to the contribution are in fact distributed in a timely manner to eligible organizations.⁴²¹ Usually the underlying documents provide that amounts will be paid to the community foundation, in the absence of any designation by the donor, to satisfy this requirement.

Illustrations of how a community foundation can establish such a pooled donor-directed fund can be found in Rev. Rul. 80-305⁴²² and in Private Letter Ruling 8711056 (Dec. 16, 1986).⁴²³

⁴²⁰ Treas. Reg. Section 1.170A-9(h) (3).

⁴²¹ Treas. Reg. Section 1.170A-9(h) (3).

⁴²² Rev. Rul. 80-305, 1980-2 C.B. 71. A community foundation established a tax-exempt trust to receive donations that would be pooled in a common fund. The trust then distributed all of its income in a timely manner to organizations that were publicly supported organizations under Section 509(a) (1) in accordance with the requirements of Section 170(b) (1) (D) (iii).

The trust was subject to the control of the community foundation's distribution committee, and if a donor did not exercise his right to designate a recipient, the funds were disbursed in accordance the distribution committee's direction. The distribution committee also had the power to replace a trustee for breach of fiduciary duty or failure to earn a reasonable rate of return on the trust principal. The IRS ruled that these powers over the trust were sufficient to establish the relationship required by Section 1.509 (a)-4(g) of the regulations. Therefore, the trust met the requirements of a "supporting organization" under Sections 509 (a) (3) (A) and (B), and would have met the requirements of Section 509 (a) (3) (C) but for the right of the donors to designate recipients. Accordingly, since the trust would have been a "supporting organization" but for the right of the donors to designate recipients, it was an organization described in Section 170 (b) (1) (D) (iii).

⁴²³ In this ruling, a public charity (presumably a community foundation) formed a corporation to administer its donor-directed funds and then selected the directors of the corporation. Under the tax laws, the corporation was a non-component fund and was classified as a private foundation.

The corporation then executed a trust agreement to create a common fund in which contributions from individuals would be pooled. The agreement provided for the timely distribution of income and principal to Section 509(a) (1) public charities designated by the donors. In the absence of designation, the bank trustee was to make all required distributions of income and principal to the community foundation. The community foundation also received a specified minimum percentage of income and principal attributable from each donor's gift, pursuant to the income and principal election forms completed by each donor.

The corporation also amended the trust agreement to permit donors to contribute insurance policies and other deferred gifts. The trustee was designated as beneficiary of all insurance proceeds, and was required to distribute the proceeds to the public charities designated by the donors. The donors paid all of the premiums due under gift contracts or policies, and neither the trustee nor the corporation had any obligation to pay premiums or other related charges.

The IRS ruled that contributions to the donor-directed funds of the corporation (which was classified as a private foundation) qualified for the same favorable tax treatment as contributions to a public charity. Furthermore, IRS ruled that the trust did not have to file a separate tax return but „as, instead, considered part of the corporation. In addition, the trust's receipt of insurance policies and other deferred gifts did not adversely affect the corporation's tax status. The IRS recognized that limited or no income would result from such gifts prior to the death of the donor, but it acknowledged that the tax regulations did not require donors to contribute income-producing assets to donor-directed funds. Rather,

c. Controversy over Public Charity Status

The statutes and regulations contemplate that a 170(b) (1) (E) (iii) donor-directed fund will be a private foundation.⁴²⁴ This will clearly be the case when an attorney prepares a donor-directed fund for a client and the only contributors are the client and related family members.

In the early 1990s, several donor-directed funds raised the argument that they could qualify as public charities. They contended that so many unrelated people contributed to them that they should be classified as public charities because they could pass the public support test. Their arguments were based on an interpretation of the statute⁴²⁵ and a 1988 General Counsel Memorandum that concluded that intermediary organizations could treat contributions to donor-directed funds and to other earmarked funds as public support.⁴²⁶ At least two community foundations were able to reclassify the tax status of their Section 170(b) (1) (E) (iii) donordirected funds from private foundations to public charities based on these arguments. Some community foundations created new forms of donor-directed funds, which are described below.

3. NEW FORMS OF DONOR DIRECTED FUNDS

Bolstered by the success of the Section 170 (b) (1) (E) (iii) funds that were able to convert from private foundations to public charities, a few community foundations established donor-directed funds that differed from the statute. For example, some funds permitted grants to Section 509 (a) (2) and 509 (a) (3) public charities. The legal developments also caught the attention of other organizations, notably investment firms and mutual funds, which saw an opportunity to enter the charitable arena.

The growth of donor-directed funds was significantly curbed when the IRS became aware that commercial enterprises were establishing such funds. It revoked the GCM in

favorable tax treatment was conditioned on the required distribution of all income allocable to a donor's gift, even if there was very little.

⁴²⁴ Sections 170(b) (1) (A) (vii) and 170(b) (1) (E) (iii); Treas. Reg. Section 1.170A-9(h) (1).

⁴²⁵ One argument was that a literal reading of Section 170(b) (1) (E) (iii) seemed to involve a donor-directed fund that was attempting to be classified as a public charity on the basis of being a Section 509(a) (3) "supporting organization," but that it failed that test because of donor control. The statute and regulations were silent on what would happen if the organization attempted to qualify as a public charity under a different test: the Section 509 (a) (1) public support test.

⁴²⁶ In GCM 39748 (Aug. 3, 1988-withdrawn by GCM 39875 (June 26, 1992)), the IRS concluded that contributions to a charity's donor-directed funds could be used to measure that organization's public support. This was the case even though contributions were earmarked or the donors controlled the selection of the ultimate grant recipients. In Private Letter Ruling 8822096 (Mar. 11, 1988), the IRS reached a similar conclusion with respect to funds described in Section 170(b) (1) (E) (ii) (which are slightly different from donor-directed funds described in Section 170(b) (1) (E) (iii)). The IRS withdrew the GCM in 1992 (see the next footnote). See, also, Chapter TWO for the public support test and the controversy over donor-directed funds and Bank, Malvin, "Community Foundations: Are `Donor Directed' Funds New Vehicles for Utilizing Community Foundations?," *The Exempt Organization Tax Review* (Jan. 1993).

1992 to reconsider its position on the issue.⁴²⁷ In its 1995 training manual, the IRS appears to be moving toward a position that contributions received by donor-directed funds will not qualify as support for purposes of the public support test.⁴²⁸ This would effectively classify an organization that did nothing but administer donor-directed funds into a private foundation.⁴²⁹

The IRS now appears to take a rather hostile stand toward donor-directed funds, particularly such funds that are established by commercial businesses. In one case, it refused to grant charitable Section 501 (c) (3) tax status to a commercially based directed fund, but it relented when the organization switched to advised funds.⁴³⁰ In 1995, the IRS announced an audit program of donor-directed funds, with an emphasis on funds established by commercial businesses.⁴³¹ Donor-directed funds are clearly a sensitive issue with the IRS and one can expect that there will be controversy surrounding them for the remainder of the decade.

⁴²⁷ GCM 39875 (June 26, 1992). "Whether or not GCM 39748 was a contributing factor to the growing trend in the commercialization of donor-directed funds, it was withdrawn by the Service with GCM 39875 (June 26, 1992), and does not represent the Service's position." *1995 (for FY 1996) IRS Exempt Organizations CPF, Technical Instruction Program Textbook: Part II*, Chapter M: "Donor-Directed Funds" at p. 333-334.

⁴²⁸ *1995 (for FY 1996) IRS Exempt Organizations CPF. Technical Instruction. Program Textbook: Part II*, Chapter M: "Donor-Directed Funds. "

⁴²⁹ The public support numerator would always be "zero." See Section TWO.D.

⁴³⁰ "The Scudder Charitable Foundation Qualifies for (c) (3) Exemption;" *94 Tax Notes Today* 219-63 (Nov. 8, 1994).

⁴³¹ "ABA Tax Section Meeting: Owens Discusses EO Work Plan," *95 Tax Notes Today* 99-23 (May 22, 1995).