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July 31, 2007

House Ways and Means Committee
Oversight Subcommittee
United States House of Representatives
1136 Longworth House Office Building
Washington, D.C. 20515

Re: Provisions Relating to Tax-Exempt Organizations in the Pension Protection Act of 2006

Dear Sir or Madam:

The American Bankers Association (ABA) appreciates this opportunity to comment on certain provisions of the Pension Protection Act of 2006 (Act, or PPA) affecting Type III supporting organizations. The Subcommittee seeks comments on how the Act has affected charities and foundations, in particular, if any difficulties have arisen in implementing the provisions. We would like to share with the Subcommittee the experiences of our member banks that serve as trustees for Type III supporting organizations and recommend a few ways to improve the implementation of the Act.

The American Bankers Association, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks – makes ABA the largest banking trade association in the country. Nearly two thousand banking institutions offer trust and investment services to clients.

Background on Type III Supporting Organizations

As defined under the Internal Revenue Code (IRC), a supporting organization is a public charity organized and operated for the benefit of one or more publicly supported organizations. The IRC divides these supporting organizations into three types: Type I, Type II, and Type III. Type III supporting organizations (Type III) are “operated in connection with” and not supervised or controlled by the charities they support. Type III supporting organizations:

- must be organized and operated exclusively for the benefit of or perform duties for one or more publicly supported organizations;
- must be operated, supervised, or controlled “in connection with” one or more publicly supported organizations;

- may not be controlled by a disqualified person, such as a substantial donor and his or her family members;
- must meet the “integral part” test by being involved in the charities’ operations to the extent that the charities are dependent on the supporting organization.

Many Type III supporting organizations have the trust departments of ABA members as corporate trustees. As an example, one typical large Midwest financial institution acts as corporate trustee for approximately 350 Type III supporting organizations. These supporting organizations made substantial annual contributions to local charities in six states, including children’s homes, old age homes, hospitals, local hunger programs, food banks, shoes for children, churches, and other family services programs. In 2004, these 350 supporting organizations distributed over \$24 million to local charities to provide for programs and services that might not otherwise have been available to the communities.

Even before the Act, Type III supporting organizations and their trustees were subject to many levels of reporting and oversight. An extensive and longstanding body of trust law imposes strict fiduciary responsibility on trustees with respect to management, investments, and distributions of these and other trusts. Furthermore, when banks serve as trustee,¹ state and federal regulatory agencies – the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, as well as the state banking commissioners – regularly examine the banks to ensure compliance with fiduciary standards and banking regulations. These examinations occur every 12-18 months, or more often if deemed necessary. When examining a bank, the examiners look for compliance with banking laws and manuals, fiduciary standards and principles, and any other guidance, including compliance with tax laws.

How the Act Affects Type III Supporting Organizations

The Act imposes a number of new conditions on Type III supporting organizations: excise taxes on certain payments; limitations on transactions between a supported organization and certain donors; a grant of regulatory authority to adopt a new payout requirement; limits on the permitted business holdings of certain supporting organizations; and new organizational, reporting, and operational requirements, including a revised “responsiveness” test to show the supporting organization is operating “in connection with” the supported organizations. Of all these new conditions, the “responsiveness test” and the need for transitional guidance are of particular concern to Type III supporting organizations.

¹ To serve as trustee, banks must be chartered under state trust law or authorized to exercise trust powers under section 92(a) of the National Banking Act.

Responsiveness Test

Before the PPA was enacted, a Type III supporting organization could satisfy the “responsiveness” test in one of two ways. Under the first test, the supporting organization had to meet extensive governance requirements of IRS Regulation 1.509(a)-4(i)(2)(ii).² Under the second test in 1.509(a)-4(i)(2)(iii), Type III supporting organizations could meet the “responsiveness” test if: (1) it is organized as a charitable trust under state law; (2) each specified supported organization is a named beneficiary under the trust’s governing instrument; and (3) the beneficiary organization has the power to enforce the trust and compel an accounting under state law.

The PPA essentially eliminated the second test for Type III supporting organizations that are organized as charitable trusts. As outlined in Subsection 1241(c) of the Act, a Type III supporting organization may no longer satisfy the responsiveness test solely because: (1) it is structured as a charitable trust under state law; (2) has a supported organization as a beneficiary of the trust; (3) and its beneficiaries may compel an accounting of the trust. Now, these Type III supporting organizations must meet the governance requirements under 1.509(a)-4(i)(2)(ii) to maintain their tax-exempt status.

Since many Type III supporting organizations were created under the previous requirements, many of these entities that are trusts now will have to convert into another legal structure in order to maintain their tax-exempt status. Such a conversion could lead to significant legal, administrative, and other costs for these entities. In light of these burdens, we encourage the creation of a transition rule that would “grandfather” those Type III supporting organizations that were in existence on the date of enactment of the PPA so that they may comply with the previous requirements for tax exemption. We note that these trusts were created by donors, desirous of making gifts to various charities, who had certain expectations about the tax-exempt status of the trusts they created. If these donors had foreseen the additional requirements imposed by the Act, they might have made outright gifts rather than gifts in trust.

Transitional Guidance Needed

Lastly, we would like the IRS to clarify whether Subsection 1241(c) would apply to the fiscal year “starting” after August 17, 2007 or “ending” after that date. Many people interpret the provision to mean tax returns for years “ending” after the date. However, under that interpretation, a Type III

² 1.509(a)-4(i)(2)(ii) requires that: (1) (a) one or more of its officers, directors, or trustees are elected or appointed by the officers, directors, trustees, or membership of the supported organization; (b) one or more members of the governing bodies of the publicly supported organizations are also officers, directors, or trustees of the supporting organization; or (c) the officers, directors, or trustees of the supporting organization maintain a close continuous working relationship with the officers, directors, or trustees of the publicly supported organizations; and (2) by reason of such a relationship, the officers, directors, or trustees of the supported organization have a significant voice in the investment policies of the supporting organization, the timing and manner of making grants, the selection of grant recipients by the supporting organization, and otherwise directing the use of the income or assets of the supporting organization.

supporting organization that had to convert to a private foundation due to the Act may need to file two different tax returns in the same fiscal year unless the IRS provides transitional rules. For instance, in 2007, a calendar-year foundation may need to file a Form 990 up to August 17, 2007, (when it was a Type III supporting organization) and Form 990-PF for the period between Aug 18, 2007, and December 31, 2007 (when it was a private foundation). Trustees for these entities would appreciate the IRS proposing transition rules, such as allowing the entity to file as a private foundation for the entire year, when making any clarification.

Similarly, we would appreciate transitional rules or guidance on how to treat charitable foundations, created before 1969, that were exempt from filing Form 1023. Currently, trustees look at this form to determine how the Type III supporting organization satisfied the “in connection with” test. Given this exemption from Form 1023, our members need to know whether these pre-1969 charitable foundations are grandfathered from the provisions of the PPA. If they are not grandfathered, we would appreciate further guidance or transitional rules from the IRS on how to treat these entities.

Conclusion

On behalf of our members acting as trustees to these tax-exempt organizations, ABA thanks the Subcommittee for examining the effect of the Pension Protection Act on Type III supporting organizations and other charitable entities. We hope this information will help the Subcommittee as it considers efforts to improve the treatment of these important charitable entities.

Sincerely,

A handwritten signature in black ink that reads "Floyd E. Stoner". The signature is written in a cursive style with a prominent initial "F".

Floyd E. Stoner

Cc: Members of the Oversight Subcommittee