

## The Special Purpose Supporting Organization

### A Tool for Community Foundations, Museums, and Public Charities to Attract and Retain Gifts of Art, Rare Books, Religious/Historically Significant Artifacts, and More

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Community foundations, museums, and public charities in general, particularly those that operate and administer donor-advised funds at scale, should consider designing “special purpose supporting organizations” to expand their philanthropic reach and attract donations of art, rare books, or religious/historically significant artifacts.<sup>1</sup> These public charities should further consider holding and administering these donations through donor-advised funds, using the special purpose supporting organization as the sponsoring organization, as a means of keeping collectors-turned-donors engaged beyond their initial contribution.

Part I examines how public charities are not typically structured to satisfy the “related use” rules governing charitable contributions of tangible personal property. Part II explores how a Type I Supporting Organization of a public charity can be specially designed to satisfy these “related use” rules in order to attract donations of art, rare books, or religious/historically significant artifacts. Part III illustrates how incorporating donor-advised funds as the charitable vehicle to facilitate contributions of these gifts can keep donors engaged long after their gift is complete. Finally, Part IV provides practical considerations and concluding thoughts as to why public charities should implement this design to bring these donations within reach.

#### **Part I:           Donations of Tangible Personal Property – Related Use Requirement**

Art, rare books, and religious/historically significant artifacts are treated as tangible personal property for deductibility purposes. Donors receive a charitable contribution deduction equal to the fair market value of their tangible personal property only if such property satisfies the “related use” rules under Code § 170.<sup>2</sup> A gift of tangible personal property for an “unrelated use” generates a deduction that is limited to the lesser of the donor’s basis or the property’s fair market value.<sup>3</sup>

But public charities are often broadly organized and operated for one or more of the enumerated purposes under Code § 501(c)(3) (i.e., religious, charitable, scientific, literary, and educational). Indeed, this is generally a wise practice to broadly appeal to the philanthropic market.

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<sup>1</sup> Throughout this piece, the term “public charities” is used to generally refer to those organizations that serve as sponsoring organizations to donor advised funds or who serve as fiscal sponsors to charitable initiatives. The term “public charities” is also intended to include museums and other nonprofit organizations classified under Code § 509(a)(2) or § 170(b)(1)(A)(vi) that are otherwise positioned to support the proposed structure of a *Special Purpose Supporting Organization*.

<sup>2</sup> See also, Treasury Regulation § 170A-4(b)(3). Note further that a donor’s charitable contribution deduction being equal to the fair market value of the property donated assumes the property being donated is a long-term capital gain asset (being held for >1 year and qualifies as related use property).

<sup>3</sup> Code § 170(e)(1)(B)(i).

Yet the consequences of this practice place public charities at a disadvantage because they are unlikely to satisfy the “related use” rules for donations of tangible personal property under Code § 170(e). Moreover, most public charities maintain a gift acceptance policy that requires the near-immediate disposition of noncash property received as charitable gifts.<sup>4</sup>

The “related use” test under Code § 170 and the Regulations examines whether the charity recipient’s use of the property is related to “*the purpose or function constituting the basis for [the charity’s] exemption*” under Code § 501 (emphasis added). Most “related use” examples are reasonably straightforward. For example, a gift of art to an art museum who places the piece on display to the general public satisfies the related use requirement. Likewise, the donation of a collection of rare books to a public library which is then used for display or reference purposes would be a related use.

Donors may generally treat their gift as having a “related use” gift if:

- (1) He or she can establish that the property is not put to an unrelated use; or
- (2) At the time of their contribution, it is reasonable to assume that the property will not be put to an unrelated use by the charity.<sup>5</sup>

A donor is required to file IRS Form 8283 if the property donated exceeds \$5,000 and must also obtain a qualified written appraisal of the property’s value. In this case, the charity must further certify whether it intends to use the property for an unrelated use.<sup>6</sup> A charity is also required to hold the property for three years in order for a donor to receive their heightened fair market value deduction.<sup>7</sup> A charity recipient who sells donated “related use” property within three years of receipt triggers harsh recapture rules that can retroactively limit the allowable charitable contribution deduction from the property’s fair market value to the donor’s basis in the property, even if the property otherwise qualifies as a “related use” gift.<sup>8</sup>

Thus, public charities, by their nature, are not generally designed to facilitate the acceptance of art, rare books, or religious/historically significant artifacts. The solution for community foundations and public charities to satisfy the “related use” test lies in designing a special purpose supporting organization.

## **Part II: The Special Purpose Supporting Organization**

A supporting organization, specifically a Type I Supporting Organization, is perhaps the most versatile of the Code § 501(c)(3) organizations. Gifts to a Type I Supporting Organization

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<sup>4</sup> While this is an industry wide “best practice,” it can also result in unintended consequences that trigger certain recapture rules under Code § 170(e), which could cause a donor to include part of their charitable deduction as income in a later tax year.

<sup>5</sup> Treas. Reg. § 170A-4(b)(3)(ii).

<sup>6</sup> IRS Form 8283, Part V (Rev. December 2023).

<sup>7</sup> Attorneys, CPAs, and practitioners alike will likely recognize these requirements from Code § 170(e) and as set forth on IRS Form 8282 and 8283. The nuances of Form 8283 and Form 8282, while important, are outside the desired focus of this piece.

<sup>8</sup> Code § 170(e)(1)(B)(i)(II).

are deductible to a donor as if they are made to any other public charity.<sup>9</sup> But unlike public charities classified under Code § 509(a)(2) or § 170(b)(1)(A)(vi), a Type I Supporting Organization is not required to pass a public support test, thus alleviating the “burden” of having one too many significant donors.

In general, a Type I Supporting Organization must satisfy three broad requirements to obtain tax-exempt status and classification as a supporting organization:<sup>10</sup>

- 1) It must be organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more public charities;
- 2) It must be operated, supervised, or controlled by one or more public charities; and
- 3) It must not be controlled directly or indirectly by one or more disqualified persons (other than foundation managers and its public charity “parent”).

Public charities often deploy Type I Supporting Organizations to carry out fundraising or endowment activities on their behalf, or to conduct special grantmaking initiatives to carry out their exempt purposes.<sup>11</sup> Successful families and individuals are also increasingly turning to Type I Supporting Organizations in lieu of forming a private foundation. As discussed above, public charities are often broadly organized and operated for one or more enumerated purposes under Code § 501(c)(3). The basis for their exemption is likewise to further these broad enumerated purposes under Code § 501(c)(3). Of course, this weighs against the “related use test” described above, but it actually supports the framework that will facilitate the creation of a Type I Supporting Organization that is specially designed to perform the functions of and carry out one or more of the enumerated exempt purposes of a public charity.

For example, the promotion of the arts is a widely recognized *charitable* and *educational* activity within the meaning of Code § 501(c)(3). A public charity could design a Type I Supporting Organization that is organized and operated exclusively for charitable and educational purposes within the meaning of Code § 501(c)(3), and whose purposes and activities are dedicated to promotion of the arts. Consider the following exempt purpose statement:

This Supporting Organization is organized and operated exclusively for charitable and educational purposes within the meaning of Internal Revenue Code § 501(c)(3). This Supporting Organization shall be operated, supervised, or controlled by Public Charity within the meaning of Code § 509(a)(3).

This Supporting Organization’s specific purpose is to exclusively benefit, perform the functions of, and otherwise carry out the exempt charitable and educational purposes of Public Charity **through**

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<sup>9</sup> Code § 170(b)(1).

<sup>10</sup> Code § 509(a)(3)(A)-(C).

<sup>11</sup> PLR 9409038; PLR 9311033; PLR 199952088; PLR 8921060; PLR 199941048; PLR 8753049; IRS Gen. Counsel Mem. 34817.

**activities that promote, support, and educate the public about the arts.**

Here, this supporting organization is specially designed to only carry out charitable and educational activities that promote, educate, and support the arts. When this organization later applies for recognition of exemption under Code § 501(c)(3), it must submit a detailed application to ensure that the basis for its tax exemption is tailored to charitable and educational activities that promote, educate, and support the arts.<sup>12</sup> As a result, a structure is designed such that contributions of art to this supporting organization are potentially able to satisfy the “related use” test under Code § 170(e). A public charity can extrapolate this concept and design a special purpose supporting organization designed to accept contributions of rare books or religious/historically significant artifacts.

Therefore, with the right structure, a special purpose supporting organization provides the framework to further connect with potential donors of art, rare books, or religious/historically significant artifacts. But how can public charities keep these collectors-turned-donors engaged beyond their initial contribution? The answer lies in doing what most public charities are well-equipped to administer: the donor-advised fund.

**Part III: Using Donor-Advised Funds to Facilitate Donations of Art, Rare Books, or Religious/Historically Significant Artifacts**

Donor-advised funds are a prominent tool that community foundations and public charities use to facilitate charitable giving. For the unfamiliar, a donor-advised fund is defined as a fund or account that meets each of the following three conditions:

- 1) It is separately identified by reference to contributions of a donor or donors;
- 2) A “sponsoring organization” owns and controls it; and
- 3) A donor (or any person that such donor appoints or designates) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account due to the donor's status as a donor.<sup>13</sup>

The special purpose supporting organization described in Part II of this article qualifies as a “sponsoring organization” within the meaning of Code § 4966. Here, the special purpose supporting organization would own and manage the assets contributed by a donor, who, as described above, retains certain advisory privileges with respect to the distribution or investment of the property held in the fund or account.

Using the example provided in Part II, a donor-advised fund program is established by the special purpose supporting organization to accept direct contributions of art. A donor could contribute then valuable artwork to a donor-advised fund that is sponsored by the special purpose

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<sup>12</sup> It is highly recommended that a special purpose supporting organization provide significant detail and disclosure of these activities in its application for tax-exempt status to the IRS.

<sup>13</sup> Code § 4966(d)(2)(A).

supporting organization and receive a fair market value charitable deduction because the contribution will satisfy the “related use” rules under Code § 170. Unlike the current policy employed by public charities, which typically requires the liquidation noncash contributions shortly after receipt, the special purpose supporting organization would be designed to hold the art for at least three years to avoid the recapture rules described in Part I.

This holding period presents a fantastic opportunity to keep a collector-turned-donor engaged and philanthropically active. For example, the special purpose supporting organization could extend the donor’s advisory privilege to recommend lending the art for display in museums or galleries (whether gratuitously or for a fee). Indeed, the IRS has previously determined that the lending of art can be a charitable activity.<sup>14</sup> But even if the IRS were to change its position, the lending of art to museums or galleries could also be reasonably treated as an investment activity, as to which a donor still retains advisory privileges. This concept can likewise be extended to contributions of rare books and religious/historically significant artifacts and presents a fantastic opportunity to donors engaged in the philanthropic life cycle.

#### **Part IV: Practical Considerations and Concluding Thoughts**

Of course, there are significant practical considerations for public charities to consider prior to implementing a special purpose supporting organization. Museums are likely to be better situated to more immediately implement a special purpose supporting organization. However, the use of a special purpose supporting organization, and the development of the infrastructure that is necessary to implement this design, would dramatically expand the reach of community foundations and other public charities in the philanthropic arena. The level of investment and commitment to this structure should not be taken lightly. For example, public charities need to develop the infrastructure to deploy a special purpose supporting organization. They will likely need to require donors to meet certain minimum cash reserves in their donor-advised fund that will be necessary to fund the storage, maintenance, transportation, and insurance expenses associated with such property. Additionally, public charities will need employees who possess the necessary qualifications to operate a special purpose supporting organization. Specialty advisors are likely necessary to help maintain compliance, particularly with the nuance of the related use test. A comprehensive checklist of practical considerations is likewise important to develop, albeit outside the intended scope of this piece.

In sum, contributions of art, rare books, or religious/historically significant artifacts are unique charitable gifts that require a unique charitable structure. The special purpose supporting organization is the tool that community foundations, museums, and public charities can use to attract and retain gifts of art, rare books, and religious/historically significant artifacts.

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<sup>14</sup> Rev. Rul. 74-498; Private Letter Ruling 202342009; Note also that Form 990, Schedule D, Part III designates certain uses by organizations maintaining collections of art, historical treasures, and other similar assets, which includes “public exhibition, loan or exchange program, scholarly research, and preservation for future generations.”