



## LEGAL DIMENSIONS OF INTERNATIONAL GRANTMAKING

SUPPORTING ORGANIZATIONS IN INTERNATIONAL GRANTMAKING:  
A RECENT RULING SHOWS THIS IS AN IDEAL TOOL FOR MAJOR  
SUPPORT TO A FOREIGN CHARITY

By Timothy R. Lyman

**Introduction**

A “supporting organization” offers U.S. grantmakers—both foundations and corporations—a way to provide major support to a foreign charity with potentially all the convenience of domestic grantmaking. The Internal Revenue Service (IRS) has long recognized the legal possibility of establishing a supporting organization to support a foreign charity. However, this option has rarely been used. One reason is the challenge of ensuring, on the one hand, an appropriately close relationship between the U.S. supporting organization and the foreign charity it supports, and on the other hand, maintaining the required level of independence by the supporting organization in making its funding decisions. A recent favorable ruling from the IRS regarding a supporting organization formed to support a foreign university—shows a simple way to address these challenges.

**What is a Supporting Organization?**

A supporting organization is a Section 501(c)(3) organization that is treated as a public charity because of its special relationship to one or more other-named public charities—its “supported organization(s).” Four basic elements are required under the applicable Treasury Regulations.

**First**, the supporting organization must have a specified relationship with its supported organization: for example, through overlapping board members or the manner in the which the boards of both organizations are chosen. There are three possible types of relationships that a supporting organization may have with its supported organization in order to pass this “relationship test.” Some supporting organizations establish themselves like subsidiaries that are operated, supervised or controlled by the “parent,” supported organization, while others have looser connections, brother–sister type connections or even more attenuated ties.

**Second**, the supporting organization must be organized exclusively to benefit or carry out the purposes of its supported organization(s), which generally must be named on its corporate documents. This is known as the “organizational test.”

**Third**, the supporting organization must be operated exclusively so as to provide either direct support to its sup-

ported organization(s) or to members of the class of beneficiaries served by the supported organization(s). This is the so-called “operational test.”

**Fourth** and finally, the supporting organization may not be controlled by persons or organizations closely associated with it who are defined as “disqualified persons,” which include, among others, substantial contributors and persons and organizations closely associated with substantial contributors. This is known as the “control test.”

**Why is a Supporting Organization Potentially Convenient in Foreign Grantmaking?**

A supporting organization offers a convenient vehicle for significant foreign grantmaking for two basic reasons. First, because it is recognized as a U.S. public charity, U.S. foundations may make grants to it with essentially the same ease as they can to any other domestic public charity grantee, and without the need for either “expenditure responsibility” or an “equivalency determination.” [See Legal Dimensions articles “Grantmaking by Private Foundations in the International Arena” by Thomas Chomicz (Issue 49, Fall 1998), and “What’s Behind the Foreign Public Charity Equivalence Affidavit?” by Betsy Buchalter Adler and Ingrid P. Mittermaier (Issue 50, Winter 1999).] Second, because generally a supporting organization is also formed as a U.S. corporation, corporate grantmakers can make grants to it that are tax deductible, even though they are expected to be used outside the United States. [See Legal Dimensions article “Simpler Approaches to Cross-Border Giving through Domestic Collaborations” by Timothy R. Lyman (Issue 45, Summer 1997).]

Grantmakers may wish to encourage the establishment of a U.S. supporting organization for a foreign charity for three reasons: (1) when the grantmaker plans to provide (or encourage others to provide) significant support; (2) when the grantee is involved in a joint venture with a U.S. entity; or (3) when the grantee is starting a U.S. branch of operations.

**The Challenges**

In addition to meeting the four required tests for supporting organization status, a supporting organization formed to support one or more foreign charities must also satisfy the requirements generally applicable to U.S. charities with a close ongoing funding relationship to a specific foreign beneficiary organization. These organizations are often referred to as “friends of” organizations, because of the common practice of including these words and the name of



the foreign beneficiary—in the U.S. organization's name. A detailed discussion of "friends of" organizations falls outside the scope of this article and can be found in the Legal Dimensions article "How a Private Foundation Can Use 'Friends of' Organizations" by Victoria B. Bjorklund (Issue 48, August 1998). A few of the requirements applicable to "friends of" organizations merit specific mention here, because they are potentially challenging to harmonize with the requirements of supporting organization status.

Generally, the IRS is concerned that a "friends of" organization does not have a board dominated by representatives of its foreign beneficiary, and that a significant number of U.S. citizens are represented on the board. This means that in satisfying the "relationship test" for "supporting organization" status, an approach must be chosen (from among the three set forth in the applicable Treasury Regulations) that maximizes the independence of the supporting organization's board and minimizes the proportion of supported organization representatives on the board.

Another challenge in reconciling the "friends of" organization rules with the requirements of "supporting organization" status relates to the "discretion and control" that a "friends of" organization must exercise to avoid being treated as a mere conduit of earmarked funding to its foreign beneficiary. This requirement of independent decisionmaking in deciding whether and how to make grants to the foreign beneficiary stands in some potential tension with the obligation of a supporting organization to support exclusively its named supporting organization(s) or the beneficiary classes they serve.

### **An Approach that Worked**

A recent favorable ruling from the IRS regarding a supporting organization formed to support a foreign university shows a simple, but successful, approach to balancing the requirements of both "friends of" organization status and "supporting organization" status. A three-person board, composed of one representative of the foreign university, one representative of a U.S. multinational corporation wishing to support the foreign university, and one representative of an unrelated U.S. university, assured that the "relationship test" was met without violating the "control test" or permitting the supported organization to dominate the board.

A provision in the supporting organization's founding documents specifically authorized the organization to make grants of substantially all its income to the foreign university, but it also explicitly required the supporting organization's board to exercise absolute discretion and control over its property and assets, including complete discretion to stop making grants to the university at any time. The corporate funder made grants to the supporting organization as general support grants pursuant to a simple grant letter that specifically avoided earmarking funding for the foreign university. Finally, the supporting organization's grants to the foreign university were made only for specific projects reviewed and approved by the supporting organization's board in advance, and the grants were made pursuant to grant agreements requiring the university to report on its actual use of the funds.

### **Conclusion**

If the funder or funders plan to make a significant commitment to a particular foreign charity or group of charities, a properly set up supporting organization can serve as a simple, administratively convenient means of providing significant support over the long term.

## **About the Author**

**Timothy R. Lyman** is a partner in the Hartford, Connecticut, office of Day, Berry & Howard LLP, where he heads the firm's International Philanthropy Task Force. He is also president and executive director of the Day, Berry & Howard Foundation ("promoting positive developments in the law, legal scholarship and legal education"), and is a frequent commentator and advisor on the law of international philanthropy. He devised the structure of the supporting organization described in this article and drafted the successful ruling request to the IRS.

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